PERSONAL INCOME TAX COORDINATION

THE FEDERAL-PROVINCIAL TAX COLLECTION AGREEMENTS

JUNE 1991

Department of Finance Canada
Ministère des Finances Canada

Cette publication est également offerte en français.

PREFACE

I am pleased to release the discussion paper, Personal Income Tax Coordination – The Federal-Provincial Tax Collection Agreements.

While the Federal-Provincial Tax Collection Agreements have evolved over the years, they continue to operate within the same basic framework established in 1962.

In my view, the Tax Collection Agreements serve the national interest. They help to reduce complexity and duplication; promote tax harmony and thus the free flow of labour and capital across Canada and economic prosperity; help Canadians identify which order of government is responsible for their taxes; and, at the same time, provide provinces with a degree of flexibility over their tax systems. Without the Federal-Provincial Tax Collection Agreements, taxpayers could face a considerably more complicated system.

Provinces believe that limits on flexibility constrain their ability to address their own social and economic priorities. They also argue that increased flexibility could simplify their tax measures. Without increased flexibility, some provinces have raised the prospect of leaving the Agreements to establish separate tax administration systems.

I am concerned about the implications for complexity and tax harmony should provinces choose to establish separate tax systems. However, I recognize that these Agreements are not perfect and that limitations on provincial flexibility have led them to introduce a series of measures such as tax credits, surtaxes and reductions over the last two decades.

The issue addressed in this paper is whether provincial requests for increased flexibility can be achieved while reinforcing the objectives of simplicity, transparency and harmony.

The implications of any significant changes to the Federal-Provincial Tax Collection Agreements must be carefully evaluated in light of these objectives. In this regard, I am seeking the views of individual Canadians and organizations – the taxpayers and businesses which deal with the tax system on a daily basis. In particular, associations of consumers and businesses will be encouraged to participate in consultations.

I invite all Canadians to write to me with their comments before October 1. I will examine all of these comments in advance of further discussions with the provinces.

I believe strongly in public input in the decisions of government and I encourage all interested Canadians to take the time to participate in this important process.

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INTRODUCTION

In 1987, the federal government initiated a process of tax reform involving the three major elements of the federal tax system – personal and corporate income taxes and sales taxes. The goal of this comprehensive reform has been to ensure that the burden of federal taxes is distributed fairly and that the tax system strengthens Canada's competitiveness and promotes social development.

Reform of the personal and corporate income tax systems took effect in 1988. Each involved lower statutory tax rates and a broader tax base. As a result, the tax system is fairer and decisions to work, save and invest more fully reflect underlying economic conditions rather than tax considerations. In addition, since tax reform removed many tax preferences, the system is more straightforward. The third element – sales tax reform – took effect this year. Like reform of the personal and corporate income taxes, it involved a shift to lower rates and a broader tax base. The obsolete manufacturers' sales tax has been replaced by the goods and services tax (GST) – a change that makes Canada's consumption tax system fairer and more reliable and that will strengthen our national competitiveness.

However, within Canada's federal structure, provinces levy their own taxes. Coordinating these independent systems with that of the federal government – whether in the area of income or consumption taxation – is another vital element of the national tax system. On sales tax, a process of harmonization has already been launched. Quebec, Saskatchewan and Prince Edward Island have agreed to harmonize their provincial sales taxes with the federal GST. These are important steps to the goal of a fully integrated national sales tax system.

Coordinating tax systems while reflecting the diversity of the Canadian federation, as reviewed in Chapter 1, involves striking a balance among four key objectives:

- **tax harmony:** to ensure that the tax system promotes the free flow of resources across the federation;
- **flexibility:** to allow provinces to respond to differences in the structure of their economies and in the tastes and preferences of their residents;
- **simplicity:** to keep compliance costs low for taxpayers and employers; and
- **transparency:** to ensure that taxpayers know to whom they pay tax and thus to strengthen the accountability of governments.

In Canada, the changing balance among these objectives has been reflected in the ways in which the federal and provincial tax systems have been coordinated over the years. For example, as noted in Chapter 2, when personal income taxes were first introduced, there was no coordination and each jurisdiction had the maximum flexibility to determine its own tax policy. However, the consequence of this was a "tax jungle" with governments competing with each other through their tax systems. In response, the pendulum shifted to the tax rental agreements. While greatly simplifying the national system, these agreements gave provinces no

flexibility over the personal income tax system which became the preserve of the federal government. This lack of flexibility prompted Ontario and Quebec to leave the agreements in 1947, although Ontario rejoined in 1952.[1]

In response to these concerns, the Tax Collection Agreements were first signed in 1962. Since Quebec had implemented its own personal income tax in 1954, it continued to maintain that system. Under these Agreements, provinces gained the ability to determine their own revenues but accepted federal determination of the basic tax structure and design of the tax system. Under the Tax Collection Agreements, the federal government also administers corporate income taxes for all provinces except Quebec, Ontario and Alberta. However, because corporate income taxation is not under review, this paper addresses only the federal administration of provincial personal income taxes.

While the Tax Collection Agreements have evolved in some important ways and now give provinces more flexibility, they continue to operate within the basic framework established in 1962. But, times have changed. The pressures of international competitiveness have increased and with them the importance of maintaining a highly efficient tax system. The interest of the provinces in greater flexibility in the design of their income tax systems has grown significantly. At the same time, Canadians are concerned about the complexity of the tax system. And, there is an ever-increasing need to promote the accountability of governments for the taxes they impose.

Increasingly, provinces find the current system constraining. Although they are able to determine the total income tax burden, they have only limited scope to affect the distribution of taxation among income groups or to recognize different individual and family circumstances. These are largely determined by the federal government. As a result, provinces face constraints on their ability to design their tax systems to reflect their own priorities and circumstances. For this reason, some provinces are exploring the costs and benefits of leaving the Tax Collection Agreements and establishing separate tax collection systems.

At the same time, the federal and provincial governments are examining alternative approaches to providing provinces increased flexibility over their personal income taxes within the framework of the Tax Collection Agreements. As a contribution to federal-provincial discussions on possible changes, provincial officials have developed a model that would provide provinces with much greater flexibility than they now have. This paper draws on the ideas in that work. However, a more general illustrative model is used in order to bring out the fundamental issues involved in changing the framework of the Tax Collection Agreements. Conceptually, this change would involve provincial tax being calculated on the basis of taxable income (tax on income) rather than basic federal tax (tax on tax), so that provinces would have greater policy flexibility and control over tax rates and credits.

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[1] From 1947 to 1952, neither Quebec nor Ontario imposed a personal income tax.

Whether it is the illustrative model or the somewhat more constrained provincial proposal that is being considered, fundamentally these two models share the benefits of providing provinces with much greater flexibility to use their personal income tax systems to meet their social and economic priorities. At the same time, such a change may provide both orders of government with the opportunity to increase the transparency of the federally administered federal-provincial income tax system. These are important advantages. However, the central question is whether this greater provincial flexibility can be accommodated in the Tax Collection Agreements without substantially reducing their value as instruments of tax harmony and simplicity. The analysis of the implications of a move to tax on income for these important issues is the subject of Chapter 3.These issues are important for all Canadians. For this reason, this paper initiates a process of public consultation to provide individual Canadians and tax professionals with the opportunity to express their views. The public consultation process is set out in Chapter 4.

This paper puts forward a framework for considering and evaluating the implications of changes to the Tax Collection Agreements that could be undertaken to provide provinces with the flexibility they seek. The paper is designed to elicit comments, not to argue a particular view. Consequently, it does not provide proposals for change, nor does it reach conclusions on the desirability of increased provincial flexibility.

CHAPTER 1: TAX COORDINATION IN A FEDERAL STATE

FEDERALISM AND THE TAX SYSTEM

In a federation, responsibilities are shared between central and regional authorities. The precise nature of this division of responsibilities can, and does, take many forms since it is shaped by history and by the unique political, geographic, economic and social conditions in each country. However accomplished, this division represents an effort to decentralize certain responsibilities on the premise that regional governments can better adapt to local variations in economic and social circumstances and in individual preferences.

The tax system plays a central role in this division of responsibilities, and in the ability to meet them. While the primary function of the tax system is to raise revenues, it has become an increasingly important instrument in promoting social justice and economic development.

Since taxes, whether on income or consumption, are the primary source of revenue in most industrialized countries, federations must decide how to share and coordinate access to these tax fields. How this has been done in practice varies considerably from one federation to another. In Canada, the British North America Act, 1867, established the basis for joint occupation of the major tax fields by giving provinces the power to levy direct taxes within their boundaries and permitting the federal government access to any field of taxation. This provides governments with the flexibility to diversify their revenue sources. As a result, it better protects the revenues needed to fund essential programs and services from fluctuations in underlying economic conditions.

The benefits of sharing major tax fields are significant and provide provincial governments with the flexibility that has become a central feature of the Canadian federation. However, this also means that the tax policies of each government interact, and hence risk conflicting, with those of other governments. This could occur if, for example, one province taxed on the basis of residence, while another taxed on the basis of the source of income. In this case, an individual living in the first province but earning income in the second would be taxed twice. By contrast, someone living in the second province but earning income in the first would avoid tax completely. Coordination is required to avoid these consequences.

TAX COORDINATION

Tax coordination involves achieving a balance among four objectives:

- Harmonization
- Flexibility
- Simplicity
- Transparency

Harmonization

The goal of tax harmonization is more than simply the avoidance of either double taxation or the non-taxation of certain income – it is also to ensure that differences in tax policies of different governments do not inhibit or distort the efficient allocation of capital and labour. The elimination of tax-induced distortions means that resources are applied to their most productive uses, thereby increasing Canada's competitiveness in world markets and stimulating economic growth.

Central to tax harmonization is the use of a common base for taxation purposes and an accepted method to allocate that base among jurisdictions. In the personal income tax field, a common income base provides a foundation which enables each region to tax income in the same way. For example, in the absence of tax coordination, one jurisdiction might tax capital gains much more attractively than another, thereby encouraging persons with significant income from this source to locate there. Similarly, without harmonization one jurisdiction might provide a tax preference for dividends received from corporations which had their headquarters in the region. Such a policy would encourage investors to invest only in corporations based in their province, fragmenting the capital market. The end result of the differential treatment of income would be an inefficient allocation of resources, tax systems which were replete with preferences, and, consequently, no longer the stable and secure source of revenues needed to fund the social and economic programs governments provide.

Harmonization seeks to avoid this result by fostering agreement among governments on the tax base and broad elements of the tax structure so that their tax systems are relatively uniform.

Tax harmonization provides consistency and uniformity in the tax base and structure. This means that tax measures of governments complement rather than contradict each other, thus helping to maintain a free flow of capital and labour across the federation.

Flexibility

While important, tax harmonization and economic efficiency are not the only goals of public policy. A federal form of government recognizes that the needs and preferences of individuals may vary among different regions of the country. Differences in regional preferences and in economic and social structures mean that some differences in personal income taxation are inevitable and appropriate. The assignment of different responsibilities to each order of government brings with it the requirement for some flexibility to raise sufficient revenues to meet their objectives, in the manner they consider appropriate.

Furthermore, flexibility in pursuing their objectives enhances each jurisdiction's ability to provide the mix of tax and expenditure programs best suited to their individual circumstances.

Flexibility allows each government to respond in its own way to its particular social and economic priorities.

Simplicity

Tax simplification reduces compliance costs for taxpayers and lowers administrative costs for governments. However, given the increasing complexity of modern economies and the growing use of the tax system as an instrument to achieve a broader range of policy objectives than the raising of revenues, it is more difficult to design a tax system which is both straightforward and adequately recognizes varying economic and social conditions and differences in individual and family circumstances.

Furthermore, the dual structure of government in a federation makes tax simplification all the more difficult, since tax systems reflect the priorities of two orders of government. It is within these constraints that governments must work to avoid undue complexity. The development of consistent tax policies between governments is a first step towards this objective. For example, compliance burdens are significantly reduced when both governments use a common tax base and the same definitions in determining individuals' eligibility for tax credits.

Only where the degree of policy consistency is great enough is it feasible to have a single administrative process for the taxes of both orders of government. This avoids duplication for taxpayers, employers, and those administering the system. For instance, taxfilers need comply with only one set of tax rules, complete a single tax return, and deal with one administering agency. Governments also save by not having to operate separate tax administrations, thereby avoiding waste and duplication.

Simplicity minimizes the compliance costs and the administrative burden on taxfilers, employers and governments.

Transparency

It is important that governments' tax actions be clearly understood by taxpayers. This is particularly important in a federation where two orders of government are taxing the same individuals on the same income. Transparency requires that the tax measures of one government be distinguishable from those of the other. This, in turn, ensures each government can be held accountable for its decisions affecting tax burdens and the complexity of the tax system.

Transparency ensures that each government's tax burden is clear to taxpayers, and that the taxing governments can be held accountable for their actions.

Striking a balance

In determining the most appropriate form of coordination, governments must strike a balance among these four objectives – harmonization, flexibility, simplicity and transparency. Harmonization of tax policies pays important dividends: it helps ensure that the tax system does not create barriers to the free movement of labour and capital and of goods and services across the country. In this way, it promotes a more efficient economy and a more competitive country. Furthermore, to the extent

that this harmonization permits broad uniformity in the design of tax systems, it allows for a single administration with consequent benefits in lower compliance costs for taxpayers and employers and reduced administrative costs for governments.

While of great importance, these benefits run counter to the two other basic objectives of flexibility and transparency. Federalism decentralizes decision making on the premise that regional authorities are better able to respond to the needs and preferences of individuals as they vary between regions. By its nature, harmonization limits this flexibility – so a balance must be found.

Clearly, a single administration yields significant benefits. However, the simpler this administrative process – the more that the two taxes can be treated as one – the more difficult it is for taxpayers to distinguish clearly the role of each government in the tax system. In turn, this reduction in transparency risks making governments less accountable for their tax actions – again there is a need for balance.

Over all, the balances which are struck among these objectives depend upon a variety of circumstances which will vary over time and between federations. The possibility of striking a new balance in Canada, and the implications of such a change are the subject of this paper.

CHAPTER 2: TAX COORDINATION IN CANADA

HISTORY

In 1917, the federal government entered the income tax field as a means of financing the costs of the First World War. This marked the beginning of joint occupation of the personal income tax field, which until then had been used exclusively by provinces and municipalities – British Columbia in 1876 was the first province to impose an income tax, although some municipalities began levying income taxes as early as 1831.

However, it was not until the Depression, with federal, provincial and municipal governments all attempting to raise revenues in the income tax field to meet increasing demands, that joint occupation became a significant problem. For the most part, there was little or no coordination among governments on how they designed or administered their tax systems. The consequent lack of a common tax structure and non-uniformity in tax bases and rates produced large variations in tax burdens between provinces. This caused not only serious inequities but also practical obstacles to freedom of movement in Canada. In addition to these policy distortions, the resulting administrative superstructure was complex, with a multiplicity of forms, rates, and methods of calculation.

In evaluating this "tax jungle", the Royal Commission on Dominion-Provincial Relations (1940) recommended that provinces withdraw from the income tax field in order to avoid ". . . increasing friction between governmental units, increasing double taxation, increasing arbitrary, discriminatory, and confiscatory tax levies, increasing costs of tax compliance, increasing disparities in taxation burdens and government services between regions, and increasing disparities between burdens on and opportunities open to individuals"[2].

Although the provinces initially rejected these recommendations, the demands of the Second World War necessitated changes to enable the federal government to have access to sufficient funds to finance the war effort. In 1941, provinces agreed to vacate the income tax fields in return for "rental" payments[3].

Since only the federal government levied the income tax, there was a single system across the country. This removed both the inequities and the tax-based distortions in the allocation of capital and labour that had been created by the large differences in provincial personal income tax systems. Compliance costs for taxpayers and employers were also reduced because the need for separate provincial administrative structures was eliminated. The tax rental agreements continued until 1962,

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[2] *Report of the Royal Commission on Dominion-Provincial Relations*, Book II, page 134, Queen's Printer, 1940.

[3] Initially, rental payments were unrelated to the total personal income tax revenues being collected by the federal government. In the 1957 agreement, the basis for the rental payments became a proportion of taxes collected in the province.

although with significant changes: Ontario and Quebec withdrew in 1947, but did not impose personal income taxes; in 1952, Ontario re-entered the agreements while Quebec implemented its own personal income tax in 1954.

Despite providing considerable benefits, the tax rental agreements were subject to criticism. In particular, the agreements acted as a fiscal strait-jacket for provinces which were facing increasing expenditure demands. They could neither set tax rates nor use the personal income tax as a policy instrument. At the same time, tax rental agreements failed to provide even a minimum degree of transparency and therefore accountability. Even though personal income tax revenues were shared with provinces, the fact that the federal government set tax policy and collected taxes meant that there was a strong tendency for taxpayers to see the federal government as the sole taxing authority.

To move beyond the limitations of a system of tax rental agreements, the federal and provincial governments agreed to a new form of coordination in 1962 – the Tax Collection Agreements. These were signed by the federal government and all provinces except Quebec. Since Quebec had implemented its own personal income tax in 1954, it continued to maintain that system.

Although the Tax Collection Agreements are the primary instrument for coordinating the personal income tax system in Canada, they work in conjunction with other mechanisms of coordination. Particularly important is the agreement by all provinces, including Quebec, to adopt a common formula for allocating income among them for tax purposes. Such an agreement is necessary because provincial governments have the choice of taxing income either by residence – a taxpayer pays tax to the province of residence – or by source – a taxpayer pays tax to the province in which the income is earned. Were provinces to choose different methods, taxpayers who live in one province and earn income (employment, investment, etc.) in another could either be taxed twice or avoid taxes altogether. As a result of all provinces agreeing to use as residence based allocation formula for individuals (i.e. province of residence as of December 31 of the year), most taxpayers pay personal income tax in one and only one province. However, those taxpayers with business income earned in more than one province – multijurisdictional taxpayers – pay a separate tax in each province in which the business is carried on.

While Quebec maintains its own tax structure and administration, the basis on which its personal income tax is imposed remains consistent with that of the federal government and other provinces. To a large extent, this may be attributed to conventions such as the common allocation formula and the benefits to the province and its taxpayers of maintaining a tax system which parallels those of other governments.

The history of personal income tax coordination is marked by change, both in the degree and form of coordination and in the number of provinces that have entered into formal tax coordination arrangements with the federal government. Similar trends and tendencies are evident in the history of tax coordination in both the corporate income tax and sales tax fields.

Under the Tax Collection Agreements, the federal government has also agreed to administer and collect provincial corporate income tax. All provinces except Ontario and Quebec entered into the original Agreements. In 1981, Alberta withdrew from the corporate income tax agreements, but remained part of the personal income tax agreements.

Similar types of tax collection agreements have also been established recently in the sales tax field. Quebec, Saskatchewan and Prince Edward Island have decided to harmonize their sales taxes with the GST and thereby ensure common tax policy and consistent administrative procedures in the area of consumption tax.

THE TAX COLLECTION AGREEMENTS

A tax collection agreement is an institutional framework that enables different governments to exercise their rights of access to a tax field through a single administration and collection agency. In essence, a tax collection agreement is a combination of:

- **a policy framework** that ensures an adequate degree of harmonization; and
- based on this policy consistency, **a single administrative process** for the collection of the two taxes.

A high degree of harmonization in tax policies is a precondition for a system in which one order of government collects taxes on behalf of the other – taking advantage of economies of scale and eliminating the need for parallel collection structures. For taxpayers and employers, the single administrative process provides a simpler system, significantly reducing compliance costs. Thus, in entering a tax collection agreement, governments accept some limitations on their flexibility to set tax policies independently in return for the economic and administrative benefits of harmonization.

The 1962 Agreements

The Tax Collection Agreements of 1962 were designed to allow provinces to impose personal income taxes directly, while maintaining a high degree of tax uniformity among provinces and between the federal and provincial governments.

The basic terms and conditions of the 1962 Agreements were straightforward. In signing the Tax Collection Agreements, the federal government agreed to:

- collect and administer provincial personal income taxes;
- pay provinces the value of the income tax assessed; and
- provide this service without charge.

For their part, signatory provinces agreed to:

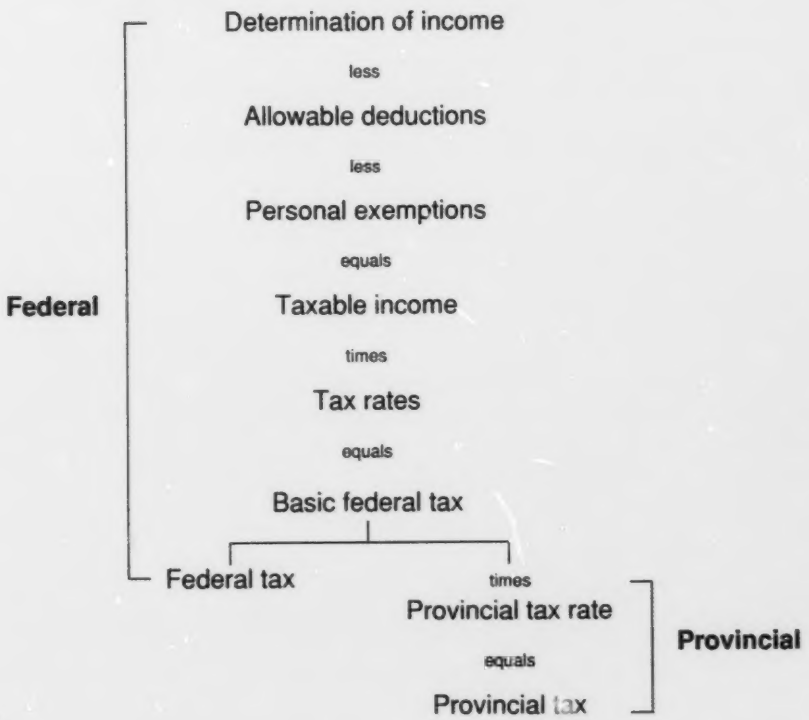
- impose a single rate of tax, calculated as a percentage of basic federal tax;
- maintain their Income Tax Acts so that they paralleled the federal Act; and

- provide the Minister and the Department of National Revenue with all the powers necessary to administer and collect provincial personal income taxes.

In contrast to the tax rental agreements where provinces had virtually no control over the income tax system, the Tax Collection Agreements gave provinces the ability to determine their revenues independently by enabling them to apply provincial tax as a single percentage of basic federal tax – the tax-on-tax framework.

Tax on tax is the foundation of the existing personal income Tax Collection Agreements. As illustrated by the following schematic of the joint calculation of federal and provincial income tax, tax on tax ensured a high degree of policy consistency between federal and provincial personal income taxation.

Federal and provincial tax calculation – 1962



Although the tax-on-tax framework provided provinces with flexibility over their tax rate and, hence, over the aggregate tax burden and revenue yield of their personal income taxes, this was the extent of their flexibility. The federal government

determined the income sources subject to tax, the allowable deductions and exemptions, and the marginal tax rates and income brackets used to compute tax. Provinces then applied a provincial tax rate to this amount to calculate the provincial tax liability.

This system resulted in a high degree of policy harmonization, making it efficient for the federal government to administer and collect provincial personal income taxes along with its own. Participating provinces had direct access to the personal income tax field without having to establish their own tax administrations. Therefore, taxfilers faced a single tax system with a relatively simple administrative process. Since the calculation of provincial tax liability simply required the application of a single percentage to basic federal tax, taxfilers needed to make only one additional computation to determine their provincial liabilities.

While offering taxpayers substantial benefits, a single administration meant that the role of provinces in imposing personal income tax was not always clear to taxfilers. In many cases, a single amount for both federal and provincial tax was reported on pay stubs. Similarly, a single annual return was completed by taxfilers and sent to the federal authorities. For this reason, it was much more difficult for taxfilers to recognize that provinces had their own tax systems, and that the federal government merely collected taxes on behalf of provinces in addition to collecting its own tax.

Undeniably, the tax-on-tax framework provided a high degree of tax harmonization and simplicity. However, this also restricted provinces from utilizing the personal income tax system as anything but a means of raising revenues. They could not use their personal income tax systems for income redistribution, or for furthering their own social and economic priorities.

The evolution of the Tax Collection Agreements

Over the three decades since the Tax Collection Agreements were originally put in place, major changes have occurred both in the role of provinces in the economy and in the use that governments make of the personal income tax system.

Throughout the 1960s and 1970s, all orders of government began to play an increasing role in the economy not only in fiscal and economic policy matters but also with regard to social policy. In particular, there was a growing interest in using the personal income tax for redistributing income. For example, the federal government introduced a number of measures, such as low-income reductions and high-income surtaxes. Also, governments were increasingly interested in developing ways to integrate their social assistance programs with the tax system. In the late 1970s, the federal government introduced the child tax credit and in 1986, the sales tax credit[4]. The objective of these credits was to strengthen the fairness of the tax system for low- and modest-income individuals and families.

[4] In December 1990, the federal government replaced this credit with an enriched and restructured GST credit.

During the same period, in response to growing interest on the part of the provinces in influencing relative tax burdens as well as aggregate tax rates, the Tax Collection Agreements were amended on various occasions to overcome at least some of the constraints of the tax-on-tax framework. Provinces modified the relative burden of provincial personal income tax by introducing low-income reductions and high-income surtaxes. Similarly, the Agreements were amended to enable provinces to use the personal income tax system to deliver social benefits by means of income-tested credits, and influence economic development through economic-incentive tax credits.

As the Tax Collection Agreements were amended to incorporate these special measures, concern arose about their impact on harmonization and simplicity. Also, as pressures for more varied types of measures increased, it became necessary for the federal government to develop a framework that would provide a consistent approach to assessing provincial requests for changes. Such guidelines had the added advantage of providing provinces with a measure of certainty about the types of special provincial measures the federal government would administer. As a result, in 1981, the federal government announced that, under the Tax Collection Agreements, it would administer special measures on behalf of the provinces so long as they:

- respected the common tax base;
- did not impede the free flow of capital, goods, services and labour within Canada; and
- could be administered effectively.

Over the years, the federal government has declined to administer some provincial proposals because they were not consistent with these guidelines. For example, one province proposed a 5 per cent dividend tax credit to be deductible from provincial income tax for dividends received from a public corporation with its head office and central management in that province. Such a measure, if implemented, would have created two fundamental problems: first, it would have encouraged businesses to locate their head offices and central management in the province; and second, it would have distorted capital markets by inducing provincial investors to invest in these special qualifying corporations at the expense of other Canadian firms.

Tax Collection Agreements today

Currently, as shown in Table 1 below, provincial tax rates as a percentage of federal tax vary from 44 per cent to 62 per cent. In addition, provinces have in place forty low-income tax reductions, surtaxes and tax credits.

Low-income tax reductions

Low-income reductions are measures used by provinces to reduce or eliminate income taxes for low-income taxpayers. These reductions eliminate provincial tax liabilities below a certain income level. Above a threshold, they are phased out gradually as income increases. In some cases, the income threshold at which the

phase-out of the tax reduction begins varies with the personal and family circumstances of the taxpayer. An important reason for the use of reductions is that an increase in the value of the basic personal credit – which would have much the same effect – cannot be accommodated in the tax-on-tax framework.

High-income surtaxes

High-income surtaxes are used by provinces to alter the distribution of their tax systems and, in particular, to make them more progressive. These surtaxes apply above a certain income threshold which is expressed in terms of basic provincial tax – for example, 10 per cent of basic provincial tax in excess of $10,000. In a tax-on-tax framework, general tax rate increases raise the tax burden of taxpayers at all income levels. Surtaxes enable provinces to raise taxes only from high-income individuals, without affecting other taxpayers.

Table 1
Provincial rates, reductions and surtaxes – 1990

Province	Basic tax rate	Low-income tax reductions	Surtaxes[1]	
			Rate	Threshold
	(per cent)		(per cent)	(dollars)
Newfoundland	62.0	–	–	–
Prince Edward Island	57.0	–	10	12,500
Nova Scotia	59.5	–	10	10,000
New Brunswick	60.0	–	–	–
Ontario	53.0	Yes	10	10,000
Manitoba	52.0	Yes	2[2]	30,000[3]
Saskatchewan	50.0	Yes	12[4]	4,000
Alberta	46.5	Yes	8	3,500
British Columbia	51.5	–	–	–
Yukon	45.0	–	–	–
Northwest Territories	44.0	–	–	–

[1] Unless noted otherwise, the surtax rate is applicable to basic provincial tax and the threshold is in dollars of basic provincial tax.

[2] The Manitoba surtax rate applies to net income.

[3] The Manitoba threshold refers to net income, and varies with individual and family circumstances.

[4] For Saskatchewan, basic provincial tax includes amounts in respect of flat taxes.

However, despite the relatively high rates at which surtaxes are imposed by provinces (currently ranging from 8 to 12 per cent), they provide only a limited ability to raise additional revenues and alter the progressivity of the provincial income taxes because they are applied on a small base. For example, assuming an individual is taxed at a federal rate of 29 per cent and the province imposes a basic tax rate of 50 per cent, a provincial surtax of 10 per cent adds 1.5 percentage points to the individual's combined federal-provincial marginal tax rate (29% x 50% x 10%).

Low-income reductions and high-income surtaxes are similar in that they provide provinces with a limited degree of flexibility to adjust the relative burden of their personal income taxes, thereby modifying the rate structure established by the federal government. Table 1 details, where appropriate, the reductions and surtaxes used by some provinces as well as the basic tax rate in each province.

Income-tested credits

Income-tested credits were the first purely provincial measures administered under the Tax Collection Agreements. In 1972, both Ontario and Manitoba introduced refundable credits to provide relief to low- and modest-income individuals from sales and property taxes. Income-tested credits are also used by Ontario and Nova Scotia to provide assistance towards purchasing a first home. In addition, British Columbia provides an income-tested, non-refundable tax credit to help offset rental costs for low-income taxpayers. Currently, all provincial income-tested credits use net family income as the basis for determining the amount of the credit and in this respect are similar to the federal child tax and GST credits.

Economic development credits

Over the years, provinces have introduced economic development credits as a means of encouraging particular forms of economic activity. There are two main types currently in use by provinces: stock savings plan tax credits and venture capital tax credits.

Stock savings plan tax credits are available to residents of a province who invest in qualifying shares of certain corporations operating in the province. The objective is to facilitate financing for corporations. Venture capital tax credits are available to individuals who invest in venture capital corporations which, in turn, invest in small businesses in the province. This is intended to provide new enterprises with improved access to capital. In recent years, credits have also been used to promote investment in machinery and equipment, and in livestock or livestock facilities, although there are currently no provincial tax credits of this type in effect.

The use of economic development tax credits illustrates an inherent conflict in setting economic policy. On the one hand, encouraging investment in certain regions and provinces contributes to a more even distribution of economic growth and the incomes that this generates. On the other hand, the use of such credits leads to inefficiencies in the allocation of resources and so diminishes Canada's overall economic growth and competitiveness.

Table 2
Provincial tax credits – 1990

	Income-tested	Economic development	Other
Newfoundland		– Stock savings plan – Venture capital	
Prince Edward Island			– Political contribution
Nova Scotia	– Home ownership savings plan	– Stock savings plan	– Political contribution
New Brunswick		– Stock savings plan	– Political contribution
Ontario	– Home ownership savings plan – Property and sales tax		– Political contribution
Manitoba	– Property tax – Cost of living		– Political contribution – Royalty tax rebate
Saskatchewan		– Stock savings plan – Venture capital – Labour-sponsored venture capital	– Royalty tax rebate
Alberta			– Political contribution – Royalty tax credit – Royalty tax rebate
British Columbia	– Renters' reduction	– Venture capital – Employee share ownership plan – Employee venture capital	– Political contribution – Royalty tax rebate
Yukon			– Political contribution
Northwest Territories			– Political contribution

Other provincial tax credits and rebates

The federal government also administers several other provincial tax credits, such as political contribution tax credits and royalty tax credits and rebates. Political contribution credits are provided in most provinces in respect of contributions made to provincial political parties, paralleling the federal political contribution tax credit.

Royalty tax rebates are provided by the four western provinces to top up the value of the federal resource allowance, effectively making royalties fully deductible for provincial purposes.

Table 2 lists all the provincial tax credits currently administered by the federal government under the Tax Collection Agreements.

FLAT TAXES

One of the key aspects of the original Tax Collection Agreements was the use of a common tax base – basic federal tax – by all provinces party to the agreements. However, in 1985, the federal government agreed to administer, on a temporary and experimental basis, a Saskatchewan tax that was to be expressed as a single rate applied to federally defined net income, known as a *flat tax*. In 1987, the federal government agreed to administer similar taxes for Manitoba and Alberta. Currently, Saskatchewan and Manitoba each levy a flat tax of 2 per cent of net income, while the Alberta flat tax is 0.5 per cent of taxable income.

Flat taxes are a major revenue-raising instrument for the three provinces which levy them and have a significant impact on provincial tax burdens and rates. Depending on the province, net income is a tax base seven to ten times larger than basic federal tax. Thus, one point of tax on net income generates seven to ten times the revenue of a point of tax applied to basic federal tax. For example, in the cases of Saskatchewan and Manitoba, a flat tax of 2 per cent on net income generates about 25 per cent of provincial personal income tax revenues. This is summarized in Table 3.

Even though flat taxes require an additional calculation, their power to raise revenues is not always clear to taxpayers. The use of both flat taxes levied on an income base and basic provincial tax levied on a (narrower) tax base, leads to confusion. For taxpayers used to tax rates which are a percentage of basic federal tax, a flat tax with its low rate may not be seen to be as powerful as it actually is.

Flat taxes are proportional taxes – that is, taxes are the same percentage of income at all income levels. Consequently, they do not respect the basic principle that taxes as a proportion of income should increase with income. Furthermore, flat taxes make it more difficult to recognize ability to pay since they ignore such circumstances as disability, medical expenses, marital status, or number of children. Because of these problems, the introduction of flat taxes was accompanied by the enhancement of existing low-income reductions and high-income surtaxes. By so doing, provinces with flat taxes have been able to mitigate the more adverse implications of flat taxes for low-income individuals.

Table 3
Revenues raised with provincial flat taxes, 1990[1]

	Flat tax revenues	Share of net provincial personal income tax	Share of basic federal tax[2]
	(millions of dollars)	(per cent)	(per cent)
Alberta	195	7.3	3.6
Saskatchewan	250	25.8	16.5
Manitoba	304	26.4	16.8

[1] Based on estimates of flat tax revenues and basic federal tax allocated to the province. These estimates do not take into account other provincial special measures, such as low-income reductions and high-income surtaxes.

[2] This column indicates the increase in the basic provincial tax rate, expressed as a per cent of basic federal tax, that would be needed to generate the amount of revenues now raised by flat taxes.

Table 4
Provincial personal income taxes as a percentage of basic federal tax, 1990

	Basic tax rate	Average effective tax rate[1]	Difference
Newfoundland	62.0	62.0	–
Prince Edward Island	57.0	57.3	0.3
Nova Scotia	59.5	59.8	0.3
New Brunswick	60.0	60.0	–
Ontario	53.0	53.6	0.6
Manitoba	52.0	63.6	11.6
Saskatchewan	50.0	64.1	14.1
Alberta	46.5	49.5	3.0
British Columbia	51.5	51.5	–
Yukon	45.0	45.0	–
Northwest Territories	44.0	44.0	–

[1] Total provincial personal income tax revenues after reductions, surtaxes and flat taxes, divided by basic federal tax of provincial taxpayers; based on Third Estimate of Payments Under the Tax Collection Agreements for the 1990 Taxation Year, Department of Finance, November 1990.

Nevertheless flat taxes in and of themselves have inherent weaknesses as major sources of revenue, particularly with respect to fairness and the loss of transparency due to the use of different tax bases. As a result, in 1988, the federal government imposed a moratorium on both the modification of existing flat taxes and the introduction of new ones. This moratorium has been extended to the end of 1991.

Table 4 illustrates how average effective personal income tax rates in some provinces now differ significantly from statutory basic tax rates due to the combination of flat taxes, low-income reductions and high-income surtaxes.

SUMMARY

The tax-on-tax approach – the linchpin of the current Agreements – places a strong emphasis on tax harmonization and simplicity for taxpayers and employers. The benefits of this harmonization are significant – a common base for taxable income, an intergovernmental tax system which is as neutral as possible with respect to economic decisions, and an efficient administrative apparatus. However, the cost of this high degree of harmonization is the need for limits on flexibility. For example, the pure tax-on-tax approach of the 1962 Agreements severely constrained the flexibility of provinces in raising taxes and in using the tax system to meet their social and economic priorities.

Over the years, increased flexibility has enabled provinces to alter the distribution of the burden of their taxes through tax reductions or surtaxes or to deliver income assistance and economic incentives through tax credits. They have also used the income tax system to a greater and greater extent as a means of delivering income support and specialized economic incentives. All of these changes reflect both the increasing role of provinces and the growing importance of personal income tax as an instrument for achieving social and economic goals.

However, the fundamental constraints imposed by the tax-on-tax framework remain: provinces are still bound by the underlying rate structure and the non-refundable credits as determined by the federal government. Faced with these constraints in the pursuit of their own economic and social priorities, provinces have had to rely on an increasingly complex array of special measures – reductions, surtaxes and tax credits. This has created a patchwork system of provincial personal income taxes as provinces search for flexibility within the current system. Some provincial governments are concerned that many of the complexities that currently confront taxpayers in calculating provincial income tax are largely the result of the necessity to use special measures to achieve provincial goals.

At the same time, in their current form, the Tax Collection Agreements do not contribute substantially to transparency. The integrated administrative system means that it is often difficult for taxpayers to determine which order of government is responsible, and therefore should be accountable, for changes in their tax burdens.

In recent years, in the face of growing interest by provinces in using the tax system as an active instrument of policy, the constraints of the tax-on-tax approach have become increasingly problematic. In their search for greater flexibility, many

provinces have become convinced of the need to move beyond the tax-on-tax framework – in effect, they argue that the opportunities for greater flexibility within the current framework have been exhausted. Indeed, while considering a range of more flexible approaches, some provinces are giving active consideration to the possibility of establishing completely independent personal income tax systems with separate tax administrations. For example, the report of the Western Finance Ministers to their Premiers, released in August 1990, proposed as an option "an independent Western Canadian income tax administration to assure reasonable flexibility in provincial tax structures to respond to provincial economic and social priorities". Their May 1991 Report welcomes the federal decision to release the discussion paper on increased provincial flexibility, but indicates that "failing adequate progress, further study of a regional tax collection structure may be undertaken later this year."

Independent tax systems would give provinces great flexibility. At the same time, however, such a step would involve a number of risks to the consistency of the national tax system and to the compliance costs it imposes on taxpayers and employers alike. The likelihood and significance of these risks would depend on the degree of informal coordination that would remain in the absence of the Tax Collection Agreements. In addition, separate tax administrations would inevitably result in duplication.

CHAPTER 3: ILLUSTRATIVE MODEL

As an alternative to the establishment of entirely separate income tax systems, the federal and provincial governments are currently exploring possible approaches to providing provinces with greater flexibility in the design of their personal income taxes within the Tax Collection Agreements. One such approach would involve provincial tax being calculated on the basis of taxable income rather than on basic federal tax. Such a change would provide provinces with greater control over their tax systems, but within the context of the Agreements. This is similar to an approach put forward in 1985 by the Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission)[5].

The issue, then, is whether this increase in flexibility would reduce tax harmonization to the extent that differences in taxes would both distort the allocation of capital and labour and diminish the efficiency gains from the common administration of federal and provincial income taxes.

In order to assess the implications of such a change, this chapter sets out an illustrative model in which a policy framework of tax on income is substituted for the existing tax-on-tax framework. This illustrative model has been designed to clarify the major differences between these two approaches. For this reason, a tax on income system in its purest form is presented here in the interests of highlighting the nature and consequences of such a change. The purpose of this model is to identify issues and choices – not to define a possible system of tax on income.

STRUCTURE OF THE MODEL

The fundamental distinction between the illustrative model and the current tax-on-tax system is the point at which provincial tax is levied. Tax on income involves provinces defining tax parameters beyond taxable income. These parameters are:

- the tax rates and income brackets over which these rates apply; and
- non-refundable credits to be deducted from taxable income to arrive at basic provincial tax.

Under the current system, because these elements are already included in basic federal tax, they are not subject to separate provincial calculations.

The illustrative model is composed of a number of key components: the income base, the rate structure, the non-refundable credits and other measures. Each is reviewed in turn.

[5] *Report of the Royal Commission on the Economic Union and Development Prospects for Canada*, Volume 3, page 397, Ottawa, 1985.

The determination of income

As in the current system, the federal government would determine the income subject to tax and the nature and level of deductions allowed in computing taxable income. Provincial tax would be based upon federally defined taxable income.

Furthermore, the general principle that individuals are taxed by the province in which they reside rather than in the province in which income is earned would be maintained. Also, residence would continue to be determined on the basis of where a person lived on December 31st. In the absence of such a rule, double taxation could occur for some individuals while others might escape tax.

Rate structure – income brackets and tax rates

As discussed above, under the current system, income thresholds and tax rates are federally defined. Since provinces impose their single tax rate as a percentage of basic federal tax, they have the same tax brackets and their effective rates are a percentage of federal rates. That is, a province with a 50 per cent tax on basic federal tax in effect has tax rates of 8.5 per cent, 13 per cent and 14.5 per cent, compared to federal rates of 17 per cent, 26 per cent and 29 per cent over the same income brackets.

The illustrative model assumes that the choice of the number and level of income brackets and tax rates would be left to each province to determine independently.

Non-refundable credits

In the current system, since provincial income tax is a percentage of basic federal tax, provinces provide a proportion of federally defined personal and other non-refundable credits. For example, a province with a 50 per cent rate implicitly provides non-refundable credits which are 50 per cent of the federal credits.

In the interests of avoiding undue complexity and maintaining a degree of consistency in the national tax system, provinces would adopt the federally defined block of non-refundable credits and the eligibility criteria for those credits:

- personal credits (basic, married or equivalent, child, disability and age);
- expense credits (C/QPP contributions, unemployment insurance premiums, tuition fees, education expenses, medical expenses); and
- other credits (charitable donations, pension income).

Nevertheless, provinces would have important areas of flexibility. They would:

- set the provincial value of these non-refundable credits;
- establish their own income thresholds and reduction rates for income-tested, non-refundable credits;

- determine whether the unused portion of non-refundable credits may be transferred to related individuals; and
- determine how these values, thresholds, rates and procedures change over time.

Provincial flexibility over the non-refundable credits gives rise to several technical issues concerning the minimum levels of credits and the transfer of unused credits. These are discussed at Annex A.

Minimum tax, dividend tax credit and other technical issues

The illustrative model also has implications for a number of measures, such as the minimum tax and dividend tax credit, which are currently included in the calculation of basic federal tax. Annex A provides a detailed analysis of these aspects of the illustrative model.

Other provincial measures

The federal government also administers other provincial tax measures – reductions, surtaxes and both income-tested and non-income tested tax credits. These measures would not be automatically affected by a move from tax on tax to tax on income since they are not part of the calculation of basic provincial tax. Thus, while provinces might wish to reconsider the use or design of these measures, the illustrative model makes no assumption about their likely courses of action.

ANALYSIS OF THE ILLUSTRATIVE MODEL

The central feature of the illustrative model is the replacement of the constraints imposed by a system of tax on tax with the greater flexibility inherent in applying provincial tax directly on taxable income. This section assesses the extent of this flexibility and analyzes its implications for the other major goals of harmonization, simplicity and transparency.

Flexibility

A federal form of government presupposes that all orders of government will have the flexibility necessary for them to carry out their responsibilities in the manner they deem appropriate. A corollary is that they should be able to tax and spend according to the needs and preferences of individuals within their jurisdictions.

The 1962 Agreements restricted provincial flexibility to determining the provincial tax rate to be applied on basic federal tax. While these Agreements have evolved to provide somewhat more flexibility for provinces, the original tax-on-tax framework remains. Consequently, provinces continue to adopt the underlying federal rate structure and the value of non-refundable credits. Thus, although provinces can determine the total tax burden or revenue yield, they have limited means to use their personal income taxes to redistribute income or to meet broader policy objectives.

Under the illustrative model, by removing the tax-on-tax constraint, provinces would be able to determine their tax rates and brackets and the values of non-refundable credits for provincial purposes. Table 5 contrasts the degree of provincial flexibility under the illustrative model with that under the current system by summarizing the provincial role in the determination of the components of provincial tax in each case.

Table 5
Determination of provincial tax

Tax component	Current system	Illustrative model
Taxable income	Federally defined	Federally defined
Rate structure	Per cent of federal rates[1]	Provincially defined
Non-refundable credits	Per cent of federal amount	Definitions fixed but values provincially defined

[1] Provinces also provide low-income reductions and impose high-income surtaxes which modify the progressivity of their systems.

Control over tax rates and brackets would provide provinces with increased flexibility to determine the progressivity of their income tax systems. They could set tax rates at all income levels – including those currently not affected by provincial high-income surtaxes and low-income reductions. In this way, the illustrative model would give provinces much greater flexibility to control the incidence of their income tax and thus to affect the overall distribution of income.

Flexibility over the value of their non-refundable credits would allow provinces to achieve policy objectives such as providing additional support to families through enhanced credits or to complement other policies administered outside the tax system – for example, to integrate to a greater degree their social assistance and tax systems.

In addition, tax on income is a more powerful means of raising revenues. For example, under the illustrative model a 1 percentage point increase in the top marginal rate would raise the same revenues as a 7 per cent surtax on provincial tax designed to have the same distributional impact. At the same time, changes to federal tax rates and non-refundable credits would no longer have a direct and automatic impact on provincial revenues.

Of course, provinces need not make full use of the flexibility provided by the illustrative model. A province could, if it wished, maintain the same level and distribution of its tax burden simply by converting its current system to one which uses taxable income. Alternatively, provinces could agree to constraints on rates, brackets and non-refundable credits and so adopt a system which provided less additional flexibility than the illustrative model. For example, such a system has already been proposed by provinces in their preliminary work on a more flexible approach to personal income taxation (attached at Annex B). Specifically, under the provincial proposal, provinces would be constrained to:

- an upper limit on the number of tax brackets of two more than the number of federal brackets; and
- providing non-refundable credits in an amount of at least 40 per cent of the value of the total federal non-refundable credit block but with the flexibility to introduce additional tax credit assistance, limited to the basic, spousal, dependent child, age, disability and other dependent credits.

Clearly, this proposal provides provinces with less flexibility than does the illustrative model. However, in the interests of clarifying the key issues for public discussion, it is the broader illustrative model which will be contrasted to the current system and which is the subject of the following sections.

Harmonization

The terms and conditions of the Tax Collection Agreements clearly emphasize the importance attached by all governments to tax harmonization. By providing that provinces impose their taxes for the most part as a single percentage of basic federal tax, the Agreements help ensure that each province's income tax system is generally consistent with the federal government's, and those of all other provinces. This consistency means that individuals with similar incomes and in similar personal and family circumstances face much the same relative progressivity regardless of province of residence. It also reduces the impact of personal income taxation on decisions as to where to reside, work, or invest.

A central feature of the illustrative model is that all provinces use a common definition of income as the base for their tax. This means that the treatment of income is uniform across provinces even though provincial tax systems may differ.

While the illustrative model maintains the common definition of income, it provides greater potential for divergence between federal and provincial governments and among provinces. The issue, then, is the extent to which these differences detract from the degree of tax harmony necessary to avoid tax-based barriers to the efficient allocation of resources.

For example, this uniform treatment of income means that tax on income does not directly affect provinces' ability to use the tax system to influence the location of investment. Under the current Tax Collection Agreements, the federal government administers provincial credits which are designed to stimulate and attract investment. However, the extent to which these credits may be used to affect

investment decisions is limited by guidelines to the Tax Collection Agreements. These guidelines must strike an inherently difficult balance between the interest of the provinces in promoting investment and the national interest in the free flow of capital.

How is an appropriate balance best struck between the interest of provinces in using the tax system to attract investment to their province and the national need to maintain a free flow of capital across Canada?

Under tax on income, greater provincial flexibility to set both rates and the value of non-refundable credits means that the burden and incidence of taxation will differ more from province to province than is the case today. Such interprovincial differences in tax systems – especially in respect of top marginal tax rates – can affect labour mobility. For example, a lower top marginal rate could act as an incentive for higher-income individuals to locate in the province offering it.

Such differences in progressivity can arise today as provinces use surtaxes or tax reductions to increase the progressivity of their tax systems. However, control over the provincial rate structure provides a more direct, effective and visible way to alter progressivity. By making use of this flexibility, it may be possible for a province to affect the tax base of other provinces in a negative way by attracting skilled, high-income workers. The only constraint, albeit an important one, would be competitive pressures between provinces.

What limitations should be incorporated into a tax-on-income framework to ensure that the tax system would be sufficiently coordinated so as not to affect unduly labour mobility within Canada?

Greater flexibility for provinces in setting their rate structures may also result in greater variations in tax burdens. This, in turn, will increase the tax differential for residents of some provinces relative to those in foreign countries and, in particular, the United States. Too great a differential will result in the emigration of some high-income earners, with the loss of their skills and entrepreneurship, putting Canada at a competitive disadvantage. While market pressures may operate to keep tax rates low, such pressures tend to have their impact, if any, only after the fact.

What implications would a move to a tax on income system have for Canada's competitiveness?

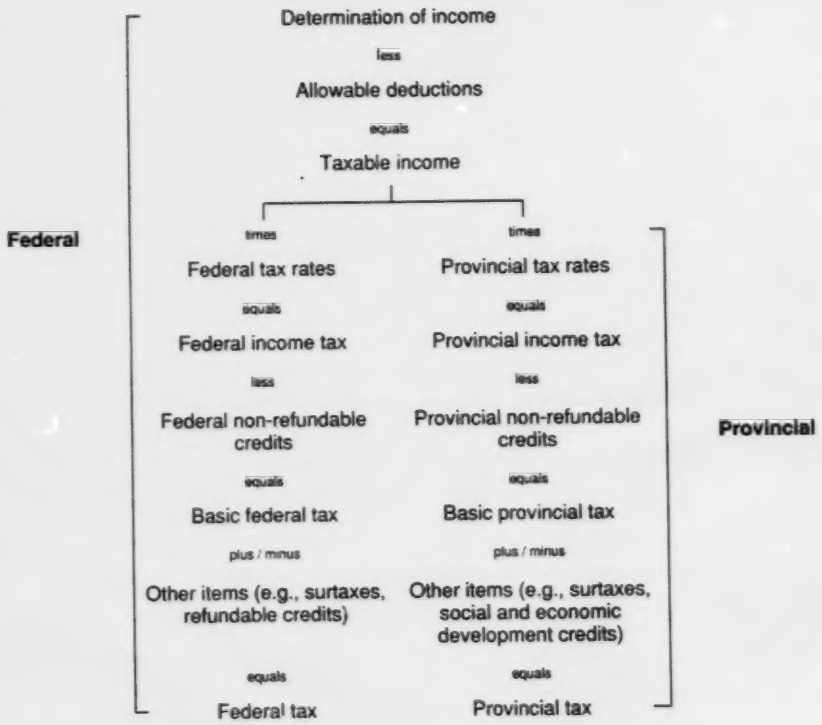
If it were decided to move to tax on income, what are the key mechanisms that should be put in place to ensure that our national competitiveness would not be diminished? Should these mechanisms also try to limit tax competition among provinces?

Simplicity

One of the major benefits of the Tax Collection Agreements is the degree to which they have simplified the federal-provincial tax system. The integrated tax administration that they permit allows taxpayers and employers to act in many cases as if there were a single system. Of course, to the extent the federal and provincial tax systems diverge, these benefits can be diminished – potentially significantly.

The following diagram provides a schematic outline of the calculation of provincial taxes under the illustrative model and compares it to the calculation of federal taxes.

Federal and provincial tax calculation



As illustrated in the diagram, both federal and provincial governments would continue to use a common tax base in the illustrative model. This would contribute significantly to maintaining a minimum degree of coordination between the federal and provincial systems. This ensures that taxable income is calculated only once and that, in case of dispute, only one review and appeal process is necessary.

After taxable income has been calculated, provincial tax systems would parallel the federal personal income tax structure. This parallelism would involve separate federal and provincial tax calculations. For example, provincial flexibility over tax rates and the value of non-refundable credits for provincial purposes would mean that taxfilers would calculate these items twice – once for federal purposes and again for provincial purposes. However, it also means provincial personal income taxes would have the same general structure, use the same definitions and require the same administrative procedures as the federal system.

Taxfilers

For most taxfilers their principal point of contact with the tax system is the requirement to complete and file their income tax returns. Under the current system, once a taxpayer has determined basic federal tax, few additional lines are needed to determine basic provincial tax. Under the illustrative model, additional steps would be necessary.

First, taxfilers would compute provincial tax on taxable income. For some taxfilers this amount, like the corresponding federal amount, could be obtained directly from the tax tables. For others – those who use the detailed tax schedule – additional calculations would be needed.

All taxfilers would then determine the value of provincial non-refundable credits. Some credits, such as the basic personal credit and the age credit, would require one line each. Others, including the credits for a dependent spouse or children, would often require additional calculations – primarily because the value of these credits is reduced as the income of the dependent spouse or children increases. This ensures that a spouse or a child cannot simultaneously be claimed as a dependent and be taxable in their own right. Finally, individuals with dividend tax credits, minimum tax carry-overs or overseas employment tax credits would have to complete additional calculations at the provincial level.

In general, for every line or calculation after taxable income that a taxfiler now completes for federal purposes, a similar calculation would be needed to compute provincial tax. This could involve as many as twenty additional calculations on the tax form. The computation of basic provincial personal income tax, under the illustrative model, is described in Table 6. A more complete sample of forms, schedules and additions to tax guides required to arrive at basic provincial tax under the illustrative model is provided at Annex C.

As discussed earlier, for many taxfilers the calculation of basic provincial tax is only the first of several steps needed to determine their provincial tax liability. These taxpayers must also determine their liability for surtaxes or eligibility for tax

Table 6
Calculation of provincial basic income tax[1]

Step 1: Gross provincial income tax

Rates of provincial income tax[2]

Taxable income	Tax
$28,275 or less	8.5%
$28,275	$2,403 plus 13% on the next $28,275
$56,550 or more	$6,079 plus 14.5% on remainder

Provincial tax
Taxable income
Tax: on the first _____ tax is _____
on remaining _____ tax at % is _____
Total tax _____

Less:

Step 2: Provincial non-refundable credits
Basic personal amount
Age amount
Married amount
Amounts for dependent children
Additional personal amounts
Canada Pension Plan contributions
Contributions through employment
Contributions payable on self-employment earnings
Unemployment insurance premium
Pension income amount
Disability amount for self
Disability amount for dependant other than spouse
Tuition fee for self
Education amount for self
Tuition fees and education amount transferred from child
Amounts transferred from spouse
Medical expenses
Substract 3% of net income or $1,542 whichever is less
Allowable portion of medical expenses

Provincial non-refundable tax credits
Charitable donations
Gift to Canada or a province
Total donations Credit claimed
Total provincial non-refundable credits

Less:

Step 3: Other Credits
Provincial dividend tax credit
Overseas employment tax credit
Provincial minimum tax carry-over from previous years

Plus:

Step 4: Provincial minimum tax

Equals:

Basic provincial tax

[1] Most provinces apply other tax credits after basic provincial tax to arrive at net provincial tax. Because the illustrative model ignores these measures, they are not shown in this table. Calculations of income-tested credits (such as the married credit) and some other credits (transferred credits) would require additional calculations in the guide and possible additional schedules.

[2] For expository purposes, tax rate figures are for a province with a 50-per-cent tax rate on basic federal tax that wishes to reproduce the same tax burdens on all taxfilers.

reduction or tax credit programs. Currently, these added features are the only means available to provinces to fine-tune their personal income tax systems. While for expository purposes the illustrative model makes no assumption as to provincial decisions with respect to these special measures, a tax-on-income framework would provide provinces with a more direct means of accomplishing their objectives. To the extent provinces modify or eliminate these special measures, this would result in greater simplicity for taxpayers.

Employers

Under the illustrative model, employers would maintain separate provincial and federal tax information for each employee. Thus, employers using the manual tax tables supplied by Revenue Canada would use two tables, one for provincial tax and one for federal tax rather than the single aggregate table now used. They would then have to combine the federal and provincial tax withheld from each employee and report to Revenue Canada the aggregate federal and provincial tax.

In the event of a more flexible system, what steps could be taken to minimize any increased compliance burden?

Transparency

Under the current tax-on-tax framework the federal and provincial roles in personal income taxation are not clear to most taxpayers. Federal changes to tax rates or to the value of non-refundable credits automatically result in changes to provincial income tax revenues, without any action or even announcement necessary on the part of provinces. Also, the fact that provinces implicitly provide non-refundable tax credits proportional in value to those provided by the federal government may not always be clear to taxpayers.

In contrast, tax on income would mean that federal tax rate changes would no longer have an automatic impact on provinces. Should provinces decide to adopt similar changes, they would have to announce and enact them in their legislation. This would increase transparency. Provinces would also provide their own non-refundable credits, making the provincial role in taxation more clear to taxfilers.

However, the increase in transparency that would result from these changes alone is probably limited because the tax systems would continue to be administered by a single agency. As the Report of the Royal Commission on Taxation, 1966 noted: "Some individuals are probably unaware that the federal government is collecting both federal and provincial personal income taxes for all provinces except Quebec. This ignorance is unlikely to be dispelled by the adoption of two separate rate schedules on a joint federal-provincial personal income tax return on a common form. Those who are unwilling to read the present tax forms are unlikely to understand the method unless there are two entirely separate returns which are filed at different places at different times".[6]

[6] *Report of the Royal Commission on Taxation*, Volume 6, page 201, Queen's Printer, Ottawa, 1966.

Strengthening transparency is important under any unified system of administration for federal and provincial income taxes, whether it is the current one or any other. However, transparency is all the more important under tax on income since it would provide provinces with significantly increased flexibility to establish their own tax policies and raise revenues. For example, were provinces to levy tax on taxable income, each point of tax would be worth seven to ten times its 1990 value, yielding in total $3.2 billion per point rather than $450 million.

It is difficult to increase transparency so long as a single agency collects both federal and provincial personal income tax. Nevertheless, one method of increasing transparency could involve the following steps.

- Report federal and provincial taxes separately on pay slips.

Indicating federal and provincial taxes deducted on pay slips would make all employees more aware of the amount of tax they pay to each order of government whether or not they seek third party help to file their annual tax returns.

- Establish separate federal and provincial calculations for purposes of instalment payments.

This would achieve a similar objective for individuals making quarterly instalment payments as the modification to the pay slips of employees.

- Modify the tax return to ensure a clear separation of federal and provincial taxes.

Since these changes would mean that the separate tracking of federal and provincial income tax (two-track system) would start with changes to the pay slips and quarterly instalment payments, it would be possible to establish the net amount of tax due to each order of government by subtracting the amount deducted throughout the year from the tax owed. The current system does not permit this because the federal and provincial portions of taxes deducted at source, or remitted either quarterly or at year end, are lumped together into a single amount. However, this two-track system would result in increased complexity for employers, because of the duplication of the deduction at source system, and for Revenue Canada because of the doubling of the information and procedures related to amounts of tax deducted at source.

What steps should be taken to improve the transparency of the tax collection system, thereby enhancing the accountability of both orders of government?

CHAPTER 4: CONSULTATION PROCESS

Proposals to modify the Tax Collection Agreements to provide provinces with greater flexibility in using their tax systems involve complex issues with important implications not only for the governments involved but also for taxpayers and employers. Consequently, to obtain the views and comments of Canadians who would be affected by any changes to the tax system, this paper launches a process of public consultation.

The basic questions to be addressed in this process are clear:

Can the increased policy flexibility that provinces are seeking be accommodated within the Tax Collection Agreements without seriously damaging their effectiveness?

If tax on income can be accommodated under the Tax Collection Agreements, what constraints, if any, should be imposed on the new system in order to:

- **maintain the benefits of a national system?**
- **avoid undue complexity and minimize compliance costs for taxpayers and employers?**
- **ensure a single administration continues to be effective?**
- **make governments more accountable for their tax policies?**

Resolving these issues involves not only assessing the adequacy of the current balance among the objectives of harmonization, flexibility, simplicity and transparency but also involves considering the need to strike a new balance among these often-conflicting goals.

This paper provides a basis for consultations by the Department of Finance with a broad range of interest groups, including representatives of industry associations, labour unions and social policy groups. These consultations will take place over the summer. Interested individuals are invited to write directly to the Minister of Finance with their views and comments.

Furthermore, in light of the nature of the issues raised by tax on income, an advisory committee of tax professionals will be established to provide advice on the technical aspects of a move to tax on income. They will report to the Minister of Finance with the results of their work in early fall.

On the basis of the advice received through these consultations, the federal government will resume discussions with the provinces in the fall to determine the degree of flexibility in provincial personal income taxation that can be most appropriately accommodated under the Tax Collection Agreements.

ANNEX A
KEY TECHNICAL ISSUES

In addition to the more general considerations analyzed in Chapter 3, there are a number of technical features which must be examined carefully in any discussion of tax on income. These key technical issues and the implications for them of the illustrative model are discussed in this annex.

NON-REFUNDABLE CREDITS

Other than the condition that provinces not introduce additional non-refundable credits or redefine existing ones, the illustrative model places no constraints on provincial flexibility in this area. This was done in order to clarify the issues raised by the substitution of the tax-on-income framework for that of tax on tax.

However, in practice, achieving adequate consistency to permit joint administration of federal and provincial credits requires that certain limitations be applied. Specifically, two aspects of the design of non-refundable credits would have to be examined in this light. They are:

- establishment of a minimum value for each credit; and
- transfer of credits between related persons.

Minimum value

The absence of any restriction on how a province determines the value of its non-refundable credits could result in a province choosing either to eliminate or substantially increase the value of one or more credits. This would result in significant differences in the treatment of individuals in similar situations but in different provinces. In addition, it would create considerable administrative complexity because taxpayers would have to determine the amount of each non-refundable credit for which they were eligible at both the provincial and the federal level.

Transfer of credits

Under the current system, the unused portion of a number of credits is transferable. These credits are:

Credit	Transferable to
Age credit	Spouse
Pension income credit	Spouse
Disability credit	Spouse or supporting parent or grandparent
Tuition and education credits (maximum $600)	Spouse or supporting parent or grandparent

All of these credits are transferable to a taxpayer's spouse. The amount of federal credits transferable to a supporting spouse is reduced by 17 per cent – the lowest federal marginal tax rate – of the net income in excess of $6,169 in 1990 of the transferring spouse. The $6,169 amount is the income level at which the tax on the net income of the spouse equals the basic personal tax credit for a single person.

Transfers to a parent or grandparent are also permitted in the case of the unused disability, tuition and education credits. Where such credits are transferred, the transferable amount is also calculated by reducing the maximum amounts by 17 per cent of the net income of the child or grandchild in excess of $6,169.

Under the tax-on-tax framework, provinces automatically provide for the transfer of these credits. In the illustrative tax-on-income approach, avoiding a situation where a filer was considered to be both a dependant and taxable in his/her own right would require that provinces adopt a system which parallels the current federal one. To the extent that they depart from federal practice, this would create inequities and additional compliance and administrative costs.

In a tax-on-income framework, what limitations, if any, should be placed on provincial flexibility over both the value of these credits and how they are transferred between related persons?

DIVIDEND GROSS-UP AND CREDIT

Dividends distributed to Canadians and paid out of after-tax corporate profits are taxable at the individual level. However, to alleviate the double taxation of these distributed corporate earnings, a special dividend gross-up and tax credit mechanism is provided. For closely-held corporations (Canadian-controlled private corporations) this mechanism integrates the corporate and shareholder taxes. That is, the levels of the dividend gross-up and credit are set to ensure that the earnings (business profits, investment income and capital gains) of a small Canadian-controlled private corporation distributed to its shareholders bear approximately the same tax as if those earnings had been earned directly by the shareholders. For larger corporations taxed at higher rates, the gross-up and credit mechanism provides partial recognition for corporate tax and provides an incentive for Canadians to invest in Canadian equities.

The example on the next page illustrates the tax treatment of dividends under the current system, assuming a small business tax rate of 20 per cent and a combined federal and provincial personal tax rate of 43.5 per cent.

In this example, the total personal and corporate income taxes paid on $100 of income earned by a corporation and distributed to its shareholders in the form of dividends would be $43.50. If the $100 of pre-tax income of the corporation had been received directly by the shareholder (i.e. only personal income taxes were paid), the federal and provincial tax liabilities would have been $29.00 and $14.50, respectively, for the same total of $43.50.

Example

	(dollars)
Corporation	
1. Corporate income	100.00
2. **Less**: federal and provincial small business tax	20.00
3. **Equals**: after-tax income distributed to shareholders	80.00
Shareholder in top tax bracket	
4. Cash dividends received	80.00
5. **Plus**: dividend gross-up (25%)	20.00
6. **Equals**: dividends included in taxable income	100.00
Federal tax	
7. Federal tax before dividend tax credit at 29%	29.00
8. **Less**: federal portion of the dividend tax credit[1]	13.33
9. **Equals**: net federal tax on shareholder	15.67
Provincial tax	
10. Federal tax times provincial rate (assuming a provincial rate of 50% of the federal tax)	7.83
11. **Total shareholder personal income tax** (9 + 10)	23.50
12. **Total corporate and shareholder tax** (2 + 11)	43.50

[1] Assuming a 50-per-cent provincial tax rate, the associated provincial portion of the dividend tax credit is $6.67, for a total of $20, the amount of tax paid at the corporate level.

Under the current system, provinces automatically recognize both the gross-up and the dividend tax credit since they are reflected in the calculation of basic federal tax, the starting point for the provincial tax calculation. Under the illustrative model, however, provincial taxes would be calculated on taxable income which includes the grossed-up dividends but not the dividend tax credit. Thus, to preserve the mechanism, a provincial dividend tax credit would have to be provided.

There are several ways in which the credit mechanism for dividends might be provided under a system in which the provinces impose their separate tax on taxable income. However designed, the important principle would be to preserve a system

that achieves a reasonable degree of integration. It is also important that a provincial dividend tax credit not differ depending on the province in which the corporation is resident or in which income is earned since such an initiative would interfere with the interprovincial allocation of resources.

What provincial dividend tax credit mechanism would be appropriate to preserve the existing degree of federal-provincial integration of the personal and corporate tax systems?

ALTERNATIVE MINIMUM TAX

Since 1986, the tax system has contained an Alternative Minimum Tax (AMT) to ensure that high-income Canadians pay their fair share of taxes. The AMT involves the recalculation of regular taxable income for taxfilers claiming preferential tax deductions such as contributions to a Registered Retirement Savings Plan and the Lifetime Capital Gains Exemption. A general deduction of $40,000 is then provided to ensure that the AMT applies only to high-income filers. Tax is calculated by applying the minimum tax rate against this tax base. The tax liability for the year is the greater of regular tax or the AMT.

An integral feature of the AMT is a carry-over of the amount of AMT in excess of the regular tax liability. This carry-over amount can be claimed in any of the seven subsequent years against the portion of the regular tax liability exceeding the AMT in those later years.

Currently, both in the year in which a taxfiler is subject to minimum tax and in the carry-over year in which there is a refund of a minimum tax liability, basic federal tax and, through it, the provincial tax liability take the minimum tax into account. Therefore, under the current system, each province shares in the minimum tax revenues and automatically provides a credit for the carry-over amount from prior years, whether or not the minimum tax liability was incurred in the province.

Under the illustrative model, there are three major elements of the AMT that would have to be considered:

- the income base;
- the tax rate and credits; and
- the carry-over provision (discussed in detail in the next section).

With regard to the income base to be used in determining the minimum tax liability, just as taxable income would continue to be federally defined, the AMT income base would also be federally defined.

The next element is the tax rate and credits to be used in determining the minimum tax liability. Under the current system, the federal rate is 17 per cent and the provincial rate is that which is applied to basic federal tax to determine provincial tax. Thus, if the provincial rate of tax is 50 per cent of the federal tax, the provincial AMT rate is 8.5 per cent. Assuming that in the illustrative model each province

would determine its own tax rate and credits for regular tax purposes, they would also determine the provincial minimum tax rate and the types of credits that could be deducted in the AMT calculation. The resulting provincial AMT would then be compared to the basic provincial tax to determine whether there was a provincial AMT liability. Because each province could set its own regular and AMT rate and credits, there would no longer be a direct correspondence between the federal and provincial AMT. There is no obvious mechanism under the illustrative model for dealing with the provincial AMT. Under a tax-on-income system it would be important to establish a means for coordinating the AMT as between provinces and between the provincial and federal systems.

What mechanisms would be appropriate to coordinate the federal and provincial minimum tax provisions in a tax-on-income system?

MEASURES WITH A CARRY-OVER PROVISION

In the current system, there are several tax measures with a carry-over provision that represent a reimbursement in one year of taxes paid in previous years. In considering the implications of tax on income, it is important to examine how carry-overs would be accommodated and also to explore the extent to which tax on income affects the federal government's ability to introduce such measures in the future.

The issue with regards to measures with carry-over provisions arises because tax on income would mean that the design of such measures could diverge significantly not only between the federal and provincial governments but also among provinces.

As noted above, the AMT is an important example of a tax measure with a carry-over provision. Under the current system, since provincial tax is calculated as a percentage of basic federal tax (which reflects the AMT liability and credit), even if Canadians move from one province to another they continue to be able to use the AMT carry-over. In the illustrative model, each province would be responsible for the design of its own AMT, and hence the issue would arise as to whether and, if so, how a province would provide an AMT credit in respect of AMT paid in another province.

Forward averaging is another measure with similar characteristics, even though it will be phased out by 1997. There are two features of this measure under the current system which require special note:

- taxable income includes amounts averaged prior to 1988 and brought back into income, and which should give rise to both a federal and provincial tax credit; and
- the carry-over feature may entitle an individual to a credit on a forward-averaging withdrawal made in a province other than the one in which the original forward-averaging tax was paid.

This could be accommodated in the illustrative model if the provinces were to provide a forward-averaging credit at the top provincial rate and agree to some

mechanism to ensure tax credits are available for amounts forward averaged in prior years, irrespective of the province to which the forward-averaging tax was previously paid. The failure of a province to reimburse taxes paid to another province in a previous year would reduce the fairness of the tax system and would constitute a barrier to the free movement of people throughout Canada.

What would be the simplest and fairest approach to coordinating tax measures with carry-over provisions in the context of a tax-on-income system?

TREATMENT OF MULTIJURISDICTIONAL TAXPAYERS

Under the current system, all income other than business income is taxable in the province in which the individual resides on the last day of the year. Taxpayers carrying on a business in several provinces pay income tax in each province. This involves first establishing the proportion of business income earned in each province, based on an allocation formula set out in the Income Tax Regulations and second, allocating basic federal tax among the provinces in which business income is earned. The taxpayer then multiplies the amount of basic federal tax allocated to each province by the appropriate provincial tax rate.

Tax on income would require a change to this system. Basic federal tax would no longer be the appropriate basis on which to distribute the provincial tax liability because provincial tax would no longer be based on it. Allocating taxable income between provinces would not be appropriate since the taxpayer would be taxed at the lowest marginal tax rate in each province. As a result, under a progressive system, the multijurisdictional taxpayer would be paying less provincial tax than a taxpayer with identical taxable income but earned in one province.

An alternative approach would be to require taxpayers to calculate a gross tax liability in each province in which business is carried on as if all income had been earned there. These amounts would then be prorated downwards by the proportion of income earned in the province to determine the actual provincial tax payable. This would yield the same result as the current system. Its drawback is the complexity and compliance burden that would be involved if each such taxpayer were required to complete a tax return for each province in which income is earned.

A significantly simpler approach would be to change the allocation rules so that all income, including business income, would be taxable only in the province of residence.

What method should be used to deal with this issue?

ANNEX B
PROVINCIAL DISCUSSION PAPER
THE APPLICATION OF PROVINCIAL TAX RATES DIRECTLY ON TAXABLE INCOME

The attached draft discussion paper was provided to the Federal-Provincial Committee on the Fiscal Arrangements on February 21, 1989 by provincial representatives of that Committee to facilitate discussions on the implications of a move towards tax on income. It was put forward as a consensus position for further federal-provincial discussion, not as representing the position of any particular government.

The following outlines the results of provincial discussions on the parameters of improved flexibility for the Federal-Provincial Tax Collection Agreements. The proposal sets out a consensus position for further federal-provincial discussion on the extent of these parameters.

What is being proposed complements the principles embodied by 1988 federal income tax reform and supports the objectives of simplicity and accountability.

BACKGROUND: THE CURRENT ARRANGEMENT

Under the Tax Collection Agreements between the participating provinces and the federal government, each province is restricted to levying only one provincial personal income tax rate on basic federal tax. The scope for a province to control its effective rate structure was initially limited, but has gradually been expanded over the years with the introduction of tax credits, tax reductions, surtaxes and flat taxes on net or taxable income, serving a variety of social and economic objectives.[1]

THE PROVINCIAL PROPOSAL

The provincial proposal involves three aspects of the tax system: the tax base, the tax rate and bracket schedule, and tax credits.

[1] Under the Tax Collection Agreements, many provinces have introduced surtaxes, flat taxes and low income tax reductions to change the progressivity of their tax system. Some provinces have introduced reductions that permit family circumstances to have a more pronounced bearing on the tax burden. Other social policy goals have been pursued as well. Finally, a number of provinces have introduced economic tax credits, such as stock savings plans, that are intended to encourage investment within their respective boundaries.

Tax base

The provincial proposal is predicated upon the retention of taxable income as defined by the federal government. The provinces recognize that the value of having the same definition of taxable income is beyond question and is the underpinning of tax harmony in Canada.

The provincial proposal will not alter this common base; the provinces accept the federal government's right to determine taxable income.

Rates and brackets

Provinces within the Tax Collection Agreements system should have the flexibility to impose separate provincial multi-rate tax structures on federally defined taxable income. Tax rates and brackets could vary according to provincial priorities. The province. agree on an upper limit of two more brackets than the number of federal brackets, i.e., five brackets under the current system. This is no more than the effective number of rates and brackets (with reductions and surtaxes) presently administered for some provinces under the Tax Collection Agreements.

Tax credits

Provinces within the Tax Collection Agreements system should have the flexibility to apply provincially determined variants of the federal non-refundable tax credits.

The provinces agree that there should be a minimum level of provincial support established for the non-refundable federal tax credits. The provinces accept the federal government's role in initiating national social and economic policies through the tax system. This includes a federal right to define the federal non-refundable tax credits and to expect a minimum level of provincial support.

Currently, provincial support is automatically provided through the application of the single provincial rate to basic federal tax. To incorporate this base level of support in a system of increased provincial tax credit flexibility, a basic provincial tax credit would be established. Each province would specify a level of provincial tax credit support not lower than 40 per cent of the value of the total federal non-refundable credit block.[2]

[2] For example, if a taxfiler had a dependent spouse (no income) and two children under the age of 18 (no income), total federal personal tax credits would equal $2,002 for 1988. In turn, assuming a basic provincial tax credit of 40 per cent, an $801 provincial tax credit would be automatically applied in calculating provincial tax.

This basic level of support for federal credits would be applied to the entire non-refundable tax credit block of federal personal tax credits.[3]

Once this minimum level of support has been established, a province would retain the flexibility to augment its tax credit support by introducing additional tax credit assistance, limited to six credits out of the sixteen in the federal block:

- basic;
- spousal (and equivalent to married);
- dependent children;
- age;
- disability; and
- other dependants.

These credit supplements would form part of the calculation of the provincial tax payable. The additional provincial personal tax credits would be deducted as part of the provincial tax calculation after determining basic provincial tax payable. There would be no additional complexity to the calculation of federal taxes. For some provinces, this will result in a simplified tax calculation.

Appendix 1 (pages 44-49) illustrates this proposal on a sample tax form.

BENEFITS OF PROVINCIAL PROPOSAL

Adoption of the provincial proposal would:

1. Strengthen the Tax Collection Agreements by enabling provincial priorities to be accommodated within the joint collection system.

2. Improve tax collection accountability. The proposal would better enable the public to clearly identify the provincial income tax and tax credit support now inherent in the combined tax system. It would also complement the interest of the federal Minister of Finance in increasing the public's awareness of provincial, as distinct from federal, responsibility for tax measures.

[3] This block includes:

Basic personal amount
Age amount
Married amount
Equivalent-to-married amount
Amounts for dependants (including children under 18, infirm dependants 18 and over and other dependants)
Additional personal amounts
Amounts transferred from spouse
Tuition fees
Education amount
Medical expenses
Charitable donations
Disability amount
CPP/QPP contributions
Unemployment insurance premiums
Gifts to Canada, a province or gifts of cultural property
Pension income amount

3. Simplify the tax system overall. It would reduce the necessity for taxpayers in many provinces to be confronted by an often bewildering assortment of tax calculations, which some provinces must resort to in order to achieve certain policy objectives through the tax system.

4. Clarify tax calculations. Applying tax on taxable income is more comprehensible to taxpayers as the provincial system would closely parallel the federal calculation of tax. Provincial tax rates would be expressed as percentages of taxable income instead of percentages of federal basic tax.

5. Reduce the need for complicated "tax back" calculations in the provision of tax based initiatives. A province would have the option of adjusting provincial tax rates and income brackets to produce the same result in a simplified manner.

6. Provide a permanent solution to the problems arising from the "temporary and experimental" nature of flat taxes.

7. Provide greater independence in formulation of federal tax policy. The federal government would no longer face the prospect of automatically increasing or reducing provincial taxes as a result of changes in federal tax rates (or to add complexity to federal tax calculations through special surtaxes which do not affect the provinces).

COMPLEMENTARY PROVINCIAL COMMITMENTS

In response to federal concerns, the following provincial undertakings would enhance the integrity of the system after the adoption of the provincial proposal:

1. Establishing a provincial dividend tax credit set by all provinces at a rate that was a fixed proportion, say 50 per cent, of the federal credit (thereby avoiding tax competition while maintaining integration between the personal and corporation income tax systems);

2. Providing, until 1997, a forward-averaging tax credit for amounts that were forward averaged before 1988 and are brought back into income, and ensuring that the tax credit will be calculated on the basis of the top marginal tax rate for the province in the year it is claimed, so long as using the top marginal rate is also federal policy;[4]

[4] As part of tax reform, forward-averaging was repealed for the 1988 and subsequent taxation years. However, amounts elected to be forward averaged prior to 1988 can be brought back into income in future years up to 1997 and will entitle the taxpayer to a federal tax credit at the top marginal tax rate. Under a tax on taxable income system, the top provincial rate will be simpler to determine, since it is likely that provincial surtaxes and flat taxes will have been removed.

3. Supporting the minimum tax and the carry-forward, such that the provinces would mirror the federal calculation.[5] The provinces would also agree to levy a minimum tax rate which reflects the current level of provincial support;

4. Addressing any potential problems which the provincial proposal may create with regard to residency rules;

5. Addressing any potential problems which the provincial proposal may entail regarding multijurisdictional taxpayers with business income.[6]

FURTHER CONSIDERATIONS

1. Some provinces may not wish to fully access the proposed flexibility. Alternatively, some may wish to continue using the present system of provincial income tax assessment (i.e. applying a single rate of tax to basic federal tax).

2. The proposal also raises the opportunity for eliminating provincial surtaxes and simplifying provincial tax credit and reduction programs. However, tax credits and reductions will continue to be an attractive tool for social and economic policy purposes.

3. Further discussion and analysis are needed regarding the impact of the provincial proposal on revenue forecasting and fiscal arrangements, specifically Established Programs Financing and Equalization.

TAX FORM FOR PROVINCIAL PROPOSAL

The attached sample tax form shows one option for accommodating the provincial proposal to apply provincial tax on the taxable income base. A simpler version could be developed if a lesser degree of separation between federal and provincial items are felt desirable.

[5] The provinces would agree to parallel the federal minimum tax base and to parallel the determination of the carry-forward amount, so that federal and provincial tax credits, such as the federal political contribution tax credit and the investment tax credit, would not be permitted as deductions in computing the minimum tax. Regarding the provincial tax rate to be applied under the minimum tax, the provinces would agree either to levy a standard provincial rate that reflects an "average" of their current basic provincial rate (50 per cent), or to establish individual tax rates on a similar basis as the federal government (rates of 17 per cent to 29 per cent), which would result in a provincial rate of approximately 60 per cent.

[6] Federal officials have proposed a sensible solution whereby an individual's total national income is used to determine a gross tax payable amount in each province, this amount then being prorated downwards to obtain actual tax payable. Similarly, the credit value would also be prorated downwards in each province. (This approach might also serve to deal with residency, should the present residency rule require amendment.)

Please do not use this area

Revenue Canada Taxation / Revenu Canada Impôt

1988
T1 GENERAL

Federal and Alberta Individual Income Tax Return

Complete and mail this copy

Step 1 - Identification

If the number shown at left is not your correct Social Insurance Number, please enter correct number below

If your spouse's Social Insurance Number is not shown at left, please enter it below

Complete the following

On December 31, 1988, you were: Married 1☐ Widow(er) 2☐ Divorced 3☐ Separated 4☐ Single 5☐

Name of Spouse

Address of Spouse same as mine ☐ or

Your Date of Birth (Day / Month / Year)

Your Province or Territory of Residence on December 31, 1988, was

If you were self-employed in 1988, please state province or territory of self-employment

If you became or ceased to be a resident of Canada in 1988, give: Date of Entry (Day / Month) or Departure (Day / Month)

If taxpayer is deceased, please give date of death (Day / Month / Year)

If the name or address shown above is incorrect, print the necessary corrections below

Name (Usual First Name and Initial / Surname, Family or Last Name)

Address (Number, Street, Apt. No., P.O. Box No. or R.R. No.)

City

Province / Postal Code

Type of work or occupation in 1988

Name of present employer

Step 2 - Calculation of Total Income

Please do not use this area

Employment Income	Employment income before deductions from Box (C) on all T4 slips (attach copy 2 of T4 slips)			101	
	Commissions from Box (P) on all T4 slips, included in above total		102		
	Other employment income including training allowances, tips and gratuities, etc. (please specify)			104	
	Total employment earnings (add lines 101 and 104)			105	
Pension Income	Old Age Security pension (attach copy of T4A(OAS) slip)			113	
	Canada or Quebec Pension Plan benefits (attach copy 2 of T4A(P) slip)			114	
	Other pensions or superannuation (attach copy 3 of T4A slips)			115	
Income from Other Sources	Taxable family allowance payments (attach copy of TFA1 slip)			118	
	Unemployment Insurance benefits (attach copy 2 of T4U slip)			119	
	Taxable amount of dividends from taxable Canadian corporations (attach completed Schedule 4)			120	
	Interest and other investment income (attach completed Schedule 4)			121	
	Partnership income - limited or non-active partners only (attach completed Schedule 4)		Net	122	
	Rental income	Gross 160	Net	126	
	Taxable capital gains (attach completed Schedule 3)			127	
	Alimony or separation allowance income			128	
	Registered retirement savings plan income (attach T4RSP slips)			129	
	Other income (please specify)			130	
Self-Employment Income	Business income	Gross 162	Net	135	
	Professional income	Gross 164	Net	137	
	Commission income	Gross 166	Net	139	
	Farming income	Gross 168	Net	141	
	Fishing income	Gross 170	Net	143	
Total Income (add lines 105 to 143 inclusive - please enter this amount on line 200 on page 2)				150	

PLEASE DO NOT USE THIS AREA

605 | 680

Step 3 - Calculation of Taxable Income

2

Total Income (from line 150 on page 1) 200

Deductions from Total Income

Registered pension plan contributions	207	
Registered retirement savings plan contributions (attach receipts)	208	
Annual union, professional or like dues (attach receipts)	212	
Child care expenses (attach form T778)	214	
Allowable business investment losses	217	
Moving expenses (from form T1-M)	219	
Alimony or separation allowance paid	220	
Carrying charges and interest expenses (attach completed Schedule 4)	221	
Exploration and development expenses (attach completed Schedule 4)	224	
Other employment expenses (please specify)	229	
Other deductions (please specify)	232	
Add lines 207 to 232 inclusive	234	

Net Income (subtract line 234 from line 200) 236

Add Accumulated forward averaging amount withdrawal (from form T581) 237

239

Deductions from Net Income

Employee home relocation loan deduction (from T4 slip)	248	
Stock option and shares deductions	249	
Unemployment insurance benefit repayment payable (from calculation in guide)	250	
Limited partnership losses of other years	251	
Non-capital losses of other years	252	
Net capital losses of other years (1972 to 1987)	253	
Capital gains deduction (from form T657)	254	
Northern residents deductions (from form T2222)	255	
Additional deductions (as specified in guide)	256	
Add lines 248 to 256 inclusive	257	

Taxable Income (subtract line 257 from line 239) 260

Step 4 - Calculation of Total Non-Refundable Tax Credits

Non-Refundable Tax Credits

Basic personal amount **Claim $ 6,000.00**	300	
Age amount, if you were born in 1923 or earlier (if you did not receive the Old Age Security pension, attach a letter giving reasons) **Claim $ 3,236.00**	301	
Married amount (provide details on page 3)	303	
Amounts for dependent children (provide details on page 3)	304	
Additional personal amounts (attach completed Schedule 6)	305	
Canada or Quebec Pension Plan contributions		
Contributions through employment from Box (D) on all T4 slips (maximum $ 478.00)	308	
Contribution payable on self-employment earnings (from page 3)	310	
Unemployment insurance premiums from Box (E) on all T4 slips (maximum $ 690.56)	312	
Eligible pension income amount (maximum $ 1,000)	314	
Disability amount for self (claim $ 3,236.00)	316	
Disability amount for dependant other than spouse	318	
Tuition fees for self (attach receipts)	320	
Education amount for self (attach form T2202 or T2202A)	322	
Tuition fees and education amount transferred from child (attach form T2202 or T2202A)	324	
Amounts transferred from spouse (attach completed Schedule 2)	326	
Medical expenses (attach receipts and complete Schedule 5) 330		
Subtract 3% of "Net Income" (line 236 above) (maximum $ 1,500)		
Allowable portion of medical expenses	332	
Add lines 300 to 326 inclusive and line 332 (IF THIS AMOUNT EXCEEDS THE AMOUNT AT LINE 260, SEE "LINE 335" IN GUIDE)	335	
Non-refundable tax credits - 17% of line 335 or see Tax Table A instructions in Guide		338

Add: Charitable donations and gifts to Canada or a province (attach receipts)

Charitable donations (attach completed Schedule 5)	340		
Gifts to Canada, a province or gifts of cultural property	342		
Total Donations	344		
On the first $ 250 or less		the credit at 17% is	346
On the balance		the credit at 29% is	348

Total Non-Refundable Tax Credits (add lines 338, 346 and 348) (proceed to Step 5 on page 4) 350

Attach all required information slips, receipts, schedules and statements to the top of this page. 3

Canada Pension Plan Contribution on Self-Employment Earnings

Pensionable self-employment earnings

Add: Pensionable earnings from employment from Box (C) or Box (I) of T4 slips

Equals: Total pensionable earnings

Subtract: Basic Canada Pension Plan exemption of $ 2,600.00

Equals: Earnings subject to contribution (maximum $ 23,900.00)

Required contribution (4% of "Earnings subject to contribution", maximum $ 956.00)

Subtract: Contributions through employment (from T4 slips)

X 2 =

Canada Pension Plan Contribution Payable on Self-Employment Earnings (please enter this amount on line 310 on page 2 and also on line 432 on page 4)

Self-Employment Report

- *If you reported self-employment income on lines 135 to 143 of page 1, please complete this section.*
- *You must file a Statement of Income and Expenses with your return.*

Enter the amount of salary or wages paid in the year to your spouse *(if partnership, enter only your share)*

Complete the following for the business with the largest total income.

Employer's remittance account number

Business name

Location

Number, Street or P.O. Box No. or R.R. No.

City

Province or Territory *Postal Code*

Briefly describe the major business activity.

Has the major activity changed since last return was filed?
1. No ☐ 2. Yes ☐

If the major business activity involves the resale of goods, indicate whether: ☐ Retail ☐ Wholesale

If your major activity is trucking, indicate whether you are an "owner-operator", "leased-operator", or "broker-operator" working for a trucking concern.
1. No ☐ 2. Yes ☐

Specify the principal product(s) mined, manufactured or sold, type of construction activity or service provided, giving the approximate percentage that the revenue from each is of the total revenue.

1

2

3

Personal Amounts

Married amount - Please check ☑ box 1 or box 2.

Married on or before December 31, 1988, and supported spouse in 1988

1. ☐ whose net income in that year was not over $ 500.00 **Claim $ 5,000.00** on line 303 on page 2
2. ☐ whose net income in that year was over $ 500.00 but less than $ 5,500.00

5,500 00

Subtract: spouse's net income

Claim (please enter this amount on line 303 on page 2)

- In the year of marital breakdown, net income of your spouse is the net income while married.
- If your marital status changed in 1988, please give date of change

Day *Month*

Amounts for Dependent Children (see Guide "Line 304" for examples)

Provide details below and claim according to child's age and net income. **If child's net income exceeds $ 2,500.00, see Guide "Line 304" for calculation of a possible reduced claim.**

- **Children born in 1970 or later** - Claim **$ 388.00** for each of two children and **$ 776.00** for each additional child.
- **Children born in 1969 or earlier who are physically or mentally infirm** - Claim **$ 1,471.00** for each child.

Name of child (attach list if space insufficient)	*Relationship to you*	*Date of birth of child* Day	Month	Year	*If born in 1969 or earlier, state nature of infirmity*	*Net income in 1988 $*	*Claim*

Total claim for dependent children (please enter this amount on line 304 on page 2)

STEP 5 - CALCULATION OF FEDERAL TAX

TAX TABLE METHOD

Federal Income Tax - from Tax Table A in guide — 401

Subtract: Total non-refundable tax credits from line 350 on page 2 — 402

Federal Tax - line 401 minus line 402 (if negative, enter zero) or from line 406 on Schedule 1 — 406

Federal political contribution tax credit: Total contributions — 409

Subtract: Federal political contribution allowable tax credit (from calculation in guide) — 410

Investment tax credit — 412

Labour-Sponsored Funds tax credit — 414

Total of above credits — 416

Federal tax before federal individual surtax — 417

Add: Federal individual surtax from Tax Table B in guide or from line 419* in detailed calculations — 419

Net Federal Tax — 420

DETAILED TAX CALCULATION (SEE GUIDE) - USE THE "1988 RATES OF FEDERAL INCOME TAX" AT BOTTOM

Taxable income from line 260 on page 2 of your return

On the first _____ tax is _____

On remaining _____ tax at _____ % is _____

Total Federal Income Tax on Taxable Income — 500

Add: Tax Adjustments (please specify; see "line 500" in guide)

Subtract: **Total Non-Refundable Tax Credits** - from line 350 on page 2 — 501

Federal Dividend Tax Credit - 13 1/3% of Table amount of dividends from taxable Canadian corporations (line 120 on page 1 of your return) not to exceed "Total" above — 502

Minimum Tax Carry-over (See "line 504" in guide) — 504

Total of above credits

Basic Federal Tax — 506

Subtract:

Federal Foreign Tax Credit - make separate calculation for each foreign country

a) Income Tax or Profits Tax paid to a foreign country — 507

b) Net Foreign Income / Net Income † — 508 × ["Basic Federal Tax" plus any Dividend Tax Credit] = _____

† Net income (line 236) (or if you filed a form T581 election, use line 9 of that form - if negative, enter zero less any capital losses of other years allowed (line 253), employee home relocation loan deduction (line 248), stock option and share deductions (line 249) and capital gains deduction (line 254)

Deduct (a) or (b) above, whichever is less — 509

Federal Tax 406 * _____

Federal Individual Surtax (See "line 419" in guide)

Basic Federal Tax (line 506) Amount (A) _____

Individual Surtax - 3% of Amount (A) — 510

Subtract: Additional Federal Foreign Tax Credit from Part II of form T2209 — 511

Sub Total — 517

Subtract: Additional Investment Tax Credit from Section II of form T2038 — 518

Federal Individual Surtax 419 * _____

* Please transfer the amounts of the items identified by an asterisk (*) to the identically numbered line above

1988 Rates of Federal Income Tax

Taxable Income	Tax
$ 27,500 or less	17%
$ 27,500	$ 4,675 plus 26% on next $ 27,500
$ 55,000 or more	$ 11,825 plus 29% on remainder

Prepared for illustrative purposes only

STEP 6 - CALCULATION OF ALBERTA TAX, NON-REFUNDABLE CREDITS

CALCULATION OF ALBERTA NON-REFUNDABLE TAX CREDITS

A. Basic Alberta Credits

Total Federal Non-refundable Credits from line 350		351
50% of line 351		352

B. Supplementary Alberta Credits

Basic		353
Spousal (% of line 303)		354
Dependent Children = % of line 304		355
Other Dependants = % of line 305		356
Age		357
Disability for Self or Dependant = $ times number of disabled claimed		358
Total Supplements - (Add lines 353 through 358)		359

C. Total Alberta Non-refundable Tax Credits - Add Lines 352 and 359 360

CALCULATION OF ALBERTA TAX PAYABLE

Alberta Income Tax (Applicable to residents of Alberta on December 31, 1988)

DETAILED CALCULATION - USE THE "1988 RATES OF ALBERTA INCOME TAX" AT BOTTOM

Taxable Income from line 260 on page 2 of your return

On the first _____ tax is _____

On remaining _____ tax at _____ % is _____

Gross Alberta Income Tax on Taxable Income is 501P

Tax Table Method Only

Gross Alberta Income Tax on Taxable Income (from revised Table A in guide) is 501P

Subtractions:

50% of Federal Dividend Tax Credit from line 502	502P
Non-refundable Credits from line 360	503P
Royalty Tax Rebate (from line H on form T79)	504P
Provincial Minimum Tax Carry-over	505P
Provincial Foreign Tax Credit from Calculation on form T203G	506P
Total Subtractions	507P

Gross Alberta Income Tax on taxable income from line 501P	
Minus Total Subtractions from line 507P	423
Equals Net Alberta Tax	

1988 Rates of Alberta Income Tax

Taxable Income	Tax
$ 11,000 or less	6%
$ 11,000	$ 660 + 11% of next $ 27,000
$ 38,000	$ 3,630 + 14% of next $ 22,000
$ 60,000	$ 6,710 + 15% on remainder

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Please do not use this area

683

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CREDIT	FEDERAL		ALBERTA	
Child tax credit (attach completed Schedule 7)		444		
Federal sales tax credit (attach completed Schedule B)		446		
Canada Pension Plan overpayment		448		
Unemployment Insurance overpayment		450		
Refund of investment tax credit (from form T2038-IND)		454		
Part XII.2 tax credit (attach T3 slip)		456		
Alberta royalty tax credit				460P
Alberta tax credit				464P
Alberta Stock Savings Plan tax credit (attach form T89)				466P
Total tax deducted per information slips		470		470P
Amounts paid by instalments		476		475P
Forward-averaging tax credit (from T581)		478		478P
Total Credits		482		482P

Net Federal Tax from line 420			
Subtract: Total Federal Credits from line 482		483	
Federal Refund if less than zero, Federal Balance due if greater than zero		484	
Net Alberta Tax from line 506P			
Subtract: Total Alberta Credits from line 482P			483P
Alberta Refund if less than zero, Alberta Balance due if greater than zero			484P
Sum of lines 484 and 484P Refund if sum is less than zero, balance due if greater than zero			
Amount Enclosed			

Please attach cheque or money order payable to the Receiver General. Do not mail cash. Payment is due no later than April 30, 1969.

I hereby certify the information given in this return and in any documents attached is true, correct and complete in every respect and fully discloses my income from all sources.

Signature ( ) Telephone number Date

Name and address of any individual or firm who received compensation for the preparation of this return.

Name	Telephone number ( )
Address	

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ANNEX C
SAMPLE TAX CALCULATIONS

This Annex is comprised of sample provincial tax forms, schedules and additions to the tax guide necessary to arrive at basic provincial tax. Calculations required for social and economic development measures and other provincial tax measures are not included.

Figures in the sample forms are for 1990 assuming that a province with a rate of 50 per cent under tax-on-tax wishes to reproduce the same tax burdens on all taxfilers under a tax-on-income model.

CALCULATION OF PROVINCIAL INCOME TAX - 1990

Taxable Income (from line 260 on Federal Form) _____ 295P

Provincial Income Tax: look up the amount in Table A and report on line 299P or do the following detailed calculation:

Rates of Provincial Income Tax

Taxable Income	Tax
$ 28,275 or less	8.5%
$ 28,275	$ 2,403 plus 13% on the next $ 28,275
$ 56,550 or more	$ 6,079 plus 14.5% on remainder

Taxable income (from line 295P) _____

Tax: On the first _____ tax is _____ 297P

On remaining _____ tax at _____ % is _____ 298P

Total Provincial Tax on Taxable Income _____ 299P

CALCULATION OF PROVINCIAL NON-REFUNDABLE CREDITS

Basic personal amount	**Claim $ 6,169**	300P
Age amount, if you were born in 1925 or earlier	**Claim $ 3,327**	301P
Married amount (see guide)		303P
Amounts for dependent children (see guide)		304P
Additional personal amounts (attach completed Schedule 6P)		305P
Canada Pension Plan contributions: Contributions through employment		308P
Canada Pension Plan contributions: Contributions payable on self-employment earnings		310P
Unemployment insurance premium		312P
Pension income amount		314P
Disability amount for self		316P
Disability amount for dependant other than spouse (see guide)		318P
Tuition fee for self		320P
Education amount for self		322P
Tuition fees and education amount transferred from child (attach form 2202P or 2202AP)		324P
Amounts transferred from spouse (attached Schedule 2P)		326P

Medical expenses (complete Schedule 4) _____ 330P

Subtract 3% of net income or $ 1,542 whichever is less _____

Allowable portion of medical expenses _____ 332P _____

Add lines 300P to 326P inclusive and line 332P _____

NON-REFUNDABLE TAX CREDITS: 8.5% of line 335P _____ 338P

Charitable donations _____ 340P

Gifts to Canada or a province _____ 342P

Total donations _____ 344P **Credit claimed (see guide)** _____ 347P

Total Provincial Non-Refundable Credits _____ 350P

Subtract:

Provincial Dividend Tax Credit		360P
Provincial Minimum Tax Carry-over		361P
Sub Total		362P

Basic Provincial Tax (line 299P minus lines 350P and 357P, if negative, enter zero) _____ 370P

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Schedule 2P - PROVINCIAL AMOUNTS TRANSFERRED FROM SPOUSE

Is your spouse filing a 1990 Income Tax return? ☐ Yes ☐ No If "No", attach your spouse's income and information slips.

A - Details of your Spouse's Income

Pension income eligible for the pension income amount (from lines 115 and 129 on your spouse's return)

Old Age Security pension plan benefits (from line 113 on your spouse's return)

Canada or Quebec Pension Plan benefits (from line 114 on your spouse's return)

All other income on your spouse's return (specify)

Total Income

Subtract: Deductions from total income (from lines 207 to 235 on your spouse's return)

Spouse's Net Income

Add: Accumulated forward-averaging amount withdrawal (from line 237 on your spouse's return)

Subtract: Deductions from net income (from lines 248 to 256 on your spouse's return)

Spouse's Taxable Income

Subtract:

Provincial basic personal amount

Spouse's Canada or Quebec Pension Plan contributions

Spouse's Unemployment Insurance premiums

Equals: Spouse's Adjusted Taxable Income for Calculation of amounts transferred — A

B - CALCULATION OF AMOUNTS TRANSFERRED

Spouse's age amount

Disability amount

Spouse's tuition fees and education amount

Pension income amount

Total — B

Amounts Transferred (A minus B: please enter this amount on line 326P)

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Schedule 6P - ADDITIONAL PERSONAL AMOUNTS - 1990 (see "line 305P" in guide)

Complete this schedule if you are claiming:

(A) equivalent to married amount, or
(B) amount for dependants other than spouse and children.

- Net income of your dependants includes Old Age Security pension, net federal supplements, Canada or Quebec Pension Plan benefits, Unemployment Insurance benefits, workers' compensation payments and social assistance payments.
- Ensure that the applicable family allowance payments in respect of each dependant claimed are reported on line 118 on page 1 of your return.

Single, divorced, separated or widow(er) and supported a relative in 1990

On December 31, 1990, you were (please tick ✓ one box): ☐ Married ☐ Widow(er) ☐ Divorced ☐ Separated ☐ Single

Note: No other personal amount may be deducted by you or any other taxpayer for a person claimed for an equivalent to married amount.

If you were married and not separated from your spouse you cannot claim the equivalent to married amount.

If your marital status changed in 1990, please give date of change _____ Day _____ Month

Amount may be claimed for a relative living with you who was your parent or grandparent or who was born in 1972 or later or if born in 1971 or earlier, was a relative who is infirm and who was wholly dependant on you, or on you and others. (You may claim here only if it has been agreed that no other person will claim for the same dependant or in respect of the same dwelling.) If the address of the dependant differed from yours while attending school, provide the address where the dependant normally resides during the non-school portion of the year.

Did you maintain the dwelling where the dependant resided? ☐ Yes ☐ No
Did you reside in the dwelling where the dependant resided? ☐ Yes ☐ No

The answer to both of the above questions must be "Yes" to claim this amount.

If applicable, tick ✓ and claim item 1 or 2, and provide "Details of Dependant" below.

☐ 1. Supported relative whose net income in 1990 was not over $514.00, claim **$5,141.00** at line A _____ A

☐ 2. Supported relative whose net income in 1990 was over $514.00 but less than **$5,655.00**

Subtract: dependant's net income _____

Please enter claim at line A _____

Details of Dependant:

Name _____ *Relationship to you* * _____

Address _____ *Date of birth* _____ Day Month Year

_____

* If born in 1971 or earlier and relationship is other than parent or grandparent, state nature of infirmity: _____

(1) Parents, Grandparents, Brothers or Sisters (including in-laws)
(2) Aunts or Uncles (including in-laws)

Provide details below and claim the allowable maximum determined according to the dependant's age and net income, as follows:

Born in 1972 or later

Each of two dependants:
- if net income was not over $2,570.00, maximum claim is $399.00.
- if net income was over $2,570.00 but less than $2,969.00, maximum claim is $399.00 minus the amount by which net income exceeds $2,570.00.

Additional dependants:
- if net income was not over $2,570.00, maximum claim is $798.00 each.
- if net income was over $2,570.00 but less than $3,368.00, maximum claim is $798.00 minus the amount by which net income exceeds $2,570.00.

Born in 1971 or earlier who are physically or mentally infirm
- if net income was not over $2,570.00, maximum claim is $798.00 each.
- if net income was over $2,570.00 but less than $4,082.00, maximum claim is $1,512.00 minus the amount by which net income exceeds $2,570.00.

If any other person has also contributed to the support of a dependant listed here, the combined amount claimed by you and such other person must not exceed the maximum amount determined as above. No claim may be made here for a dependant born in 1971 or earlier who is not mentally or physically infirm.

Dependants:

	Date of Birth Day Month Year	Relationship to you	Claim
(1) Family or Last Name _____ Usual First Name _____ Address _____	_____ * Net income in 1990 $	_____ If born in 1971 or earlier, state nature of infirmity	
(2) Family or Last Name _____ Usual First Name _____ Address _____	_____ * Net income in 1990 $	_____ If born in 1971 or earlier, state nature of infirmity	

* Includes Old Age Security and Net Federal Supplements for dependants born in 1925 or earlier. If not received, state reason: _____

Total Amounts for Other Dependants _____ B

Total Additional Personal Amounts (total of amounts A and B) (please enter this amount on line 305P) _____

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ADDITIONS TO THE GUIDE

Married Amount

Base amount	$5,655 | 00	(1)
Minus your spouse's net income		(2)
Amount Allowable (line 1 minus line 2)		

Amounts for Dependant Children

Children born in 1971 or earlier and physically or mentally infirm

Base amount	$4,082 | 00	(1)
Minus your child's net income		(2)
Amount Allowable (line 1 minus line 2)		

First and Second Child

Children born in 1972 or later

Base amount	$2,969 | 00	(1)
Minus your child's net income		(2)
Amount Allowable (line 1 minus line 2)		

Third and Each Additional Child

Base amount	$3,368 | 00	(1)
Minus your child's net income		(2)
Amount Allowable (line 1 minus line 2)		

Disability Amount for Dependants Other than Spouse

Dependant's disability amount		(1)
Dependant's taxable income		(2)
Minus total of the amounts your dependant is able to claim on lines 300P to 314P		(3)
Line 2 minus line 3 (if negative, enter zero)		

Charitable Donations

If your total donations (line 344P) are $250 or less, multiply your total donations by 8.5% and enter the result on line 347P.

If your total donations are more than $250, complete the following chart and enter the result at line 347P.

Total donations					
Minus	$250 | 00	X	8.5%	=	$21 | 25 (1)
Balance		X	14.5%	=	(2)
Allowable Credit (line 1 plus line 2), enter this amount at line 347P					

Prepared for illustrative purposes only.